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THE ANTI-MONEY LAUNDERING SYSTEM IN THE CONTEXT OF GLOBALISATION: A PANOPTICON BUILT ON QUICKSAND?

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Contents

List of key abbreviations used in this thesis

AML	Anti-money laundering
BSA	Bank Secrecy Act
CTR	Currency Transaction Report
FATF	Financial Action Task Force
FCPA	Foreign Corrupt Practices Act
FinCEN	Financial Crimes Enforcement Network
FIU	Financial Intelligence Unit
KYC	Know-Your-Customer
MSB	Money Services Business
PEP	Politically Exposed Person
SAR	Suspicious Activity Report

1. Introduction

"*Globalisation has turned the international financial system into a money-launderer's dream* [. . .]" (Arlacchi, 1998, p. 5). How often have we heard this and similar statements about money laundering and globalisation in the past two decades? We have almost started taking this for granted, even though the basis of this statement has never been conclusively clarified. The statement is based on an assumption of a link between two highly elusive phenomena – globalisation and money laundering – and ultimately asserts that there is a "*need for a global attack on money-laundering*" (Arlacchi, 1998, p. 5). Despite the lack of clarity with regard to the underlying phenomena, this assumption has become so commonplace in our day-to-day language that it now appears to reflect reality, thus resulting in it becoming 'conventional wisdom.' However, we can be fooled by language.

This chapter will guide the reader to the main theme of the thesis: the adequacy of the legal term 'money laundering' in the context of globalisation, particularly the globalisation of money laundering and of the fight against it. How clear is the concept of 'money laundering' and, based on this concept, how constructive can anti-money laundering efforts be in the current globalising penal-law environment? The main theme gives rise to a number of issues which warrant examination.

1.1. Once upon a time . . .

Once upon a time, about 4000 years ago, there was a king, King Hammurabi, who ruled the Kingdom of Babylon and who was believed to be chosen by the gods to "*to bring about the rule of righteousness in the land*" (The Code of Hammurabi, paragraph 1, see Hooker (Ed.), 1910/1996; Horne, 1915; Kowalski, 2004). He administered justice and punished those who did wrong, often using methods that in our civilised society today would be regarded as too cruel. The collection of his legal decisions became known as the Babylonian Code of Hammurabi. It contains approximately 282 case laws and is considered to be one of the earliest legal codes. Hammurabi ordered his laws to be carved on a black stone slab, so that no one could change or misquote them.

However, laws did change over the years, as beliefs and views changed within the different societies. As definitions of crime have changed, so have punishments. It is difficult to generalise acts of criminality: individuals' motives vary, as do the circumstances for their actions. Crimes may be committed for very confusing reasons, but crimes for profits have a clear rationality, which is recognisable over time and space.[1] While 'theft' is a crime which has been deemed wrong, since the time of King Hammurabi, the history of other profit-related crimes is not as long, and varies according to different societies and cultures. As new economic relationships and interests developed, penal law protection against dishonesty and deceit was required.[2] Depending on the national interests, the penalisation of infractions varies, as can be observed with environmental and economic regulations. Yet the evolution of law over the years has led to some degree of commonality, which relates to an increasingly growing cohesiveness and homogeny of economic and societal interests world wide: the so-called 'globalisation'. Penal law protection of such interests also has global features.

A prominent example is the phenomenon of money-laundering. Although 40 years[3] ago money laundering was not a penal law issue, it is now internationally considered as one of the major crimes of the 21st century. The phenomenon of money laundering has been, historically, usually associated in the media with the mafia, drug dealers and other forms of organised crime. Originally, it was observed that the drive towards an anti-money laundering policy was motivated by the fear of laundering being used to channel drugs money (Van Duyne and Levi, 2005). Furthermore, policy makers aimed for more effective laws to confiscate the proceeds of drug traffickers (Stessens, 2000). As Alldridge (2008, p. 438) notes: "*money laundering, more than any other, is the crime that reflects and energizes globalization.*" He further adds: "*A common tactic in the extension of criminal law is to select 'soft targets', that is, conduct to the criminalization of which few would object, and then advance the frontiers of criminality incrementally from them onwards. Had the decision to pursue the war on drugs […] not been taken in the early 1970s, then the concern with the profits of drug dealing and consequently the entire anti-money laundering (AML) industry would not have arisen.*" The war on drugs provided the politically acceptable 'fuel', although there were more (financial) interests at stake, as we will see later.

1 For the purposes of this thesis we exclude from our analysis crimes that are claimed to be caused by mental disorder (*e.g.* kleptomania) rather than a desire for a material gain.

2 For instance, while now insider trading and market abuse are increasingly becoming a topical issue, some 10 or 15 ago we would harldy hear about such offences.

3 The phrase 'money laundering' was first publicly used during the 1970s, during the Watergate scandal (see next chapters).

Awareness of the money laundering phenomenon was apparently raised by reputed money-laundering pioneers, such as Mayer Lansky, who have become 'household names' for allegedly using numbered accounts and tax havens to hide ill-gotten gains. Today, the phenomenon of money laundering is also associated with infamous banking scandals including the financial empire of BCCI with its manifold layers of offshore holding vehicles, nominee account holders and banks-within-banks, which was caught 'red handed' in a US sting operation (Adams and Franz, 1992). History bears witness to early forms of the phenomenon and the potential to compare the US robber barons of the late 19th century with the Russian oligarchs that emerged during the 20th century and whose past business practices continue to give rise to questions about the legitimacy of their wealth. The common feature between Lansky, BCCI and the Russian oligarchs is that they all have taken advantage of globalisation in the management of their money. They have shifted money across the world, used offshore accounts and shell firms. Such techniques have the capacity to be aimed at avoiding regulatory interference.

But what is money laundering and why is it so important to make people aware of it? This is an area covered in more detail in a later section. We will note that essentially and strictly speaking, it is the false representation of crime money as legitimate earnings. In this thesis we will distinguish the strict or narrow meaning of money laundering from the broad meaning. Broadly speaking, as interpreted by policy makers, it concerns the handling of criminal incomes. It is this conduct - money laundering in broad terms - which policy makers and regulatory agencies claim that it is a threat to the integrity of the entire financial system with a devastating effect on society. They claim that staggering amounts of crime-money is being laundered every year through the global financial system. Consequently, this has become the cause of increasing concern for the international financial community. Since 11 September 2001 speculation about the use of money laundering techniques for terrorist aims has additionally fanned the flames.

With the US being the driving force behind anti-money laundering legislative developments, the international community has sought to address these concerns and enforce global policies to fight money laundering. This has affected our every-day financial life and the functioning of the global financial system with ever increasing costs for due diligence and know-your-customer compliance. Opening a bank account now means more paperwork for both business and non-business customers, as it is required by anti-money laundering legislation. A financial transaction such as transmitting money home by migrant workers usually entails some sort of basic customer identification. Also, if the value of the transaction is more than €15.000, a high level of customer due diligence checks is required, according to Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. In some countries, such as Germany, foreign currency transfers involving a minimal amount of €2.500 require customer identification checks.

For over 20 years, *i.e.* since the introduction of the first anti-money laundering laws (as discussed in this thesis), regulators have sought to curb the phenomenon of money laundering, but to little avail. As it will be reviewed in this thesis, it is not surprising that little has been achieved in reducing the money laundering volumes: by broadening the money laundering concept beyond its strict meaning to include any handling of crime money, policy makers have made the laundering phenomenon a built-in feature of people's everyday life, not just the cathedral of finance. As it happens, money laundering in the sense of handling crime money will exist, almost tautologically, as long as crime for profit exists. As a result, the fight against money laundering continues to be a priority issue on the international political agenda and a significant challenge to the financial industry. We observe a continuous search for practical solutions that would ensure the effectiveness of the fight against this unwanted elusive phenomenon while also providing a means of dealing with the ever-increasing burden imposed on the financial sector. However, this search for a solution has never included a definitive measurement of the effect of current anti-money laundering policy making on crime and our financial and economic life. This should have been the ultimate priority. But except for simply tallying the number of suspicious transactions – a process which is not usually conducted in a consistent manner – the authorities have never seriously contemplated the implementation of proper performance measures (Van Duyne, 2007a).

1.2. Evasive global control

The fight against money laundering has absorbed enormous efforts, as it is believed that by fighting money laundering we effectively fight crime for profit. It has become a common saying that money laundering is the 'Achilles Heel' of profit-oriented criminals and that the solution ensuring effective fight against crime for profit is in the fight against money laundering. As Bernasconi (1998) has pointed out, money laundering is the 'Achilles Heel' of organised crime because it makes criminals cooperate with legitimate institutions (see for comments also Stessens, 2000). However, if the fight against it is the effective solution ensuring success in the fight against crime, what has been the effect of this approach on the crime for profit thus far?

Even if the measurement of crime-markets remains an uncertain undertaking, putting the scarce evidence together, one can maintain that after two decades of fighting money laundering, crime-markets continue to 'flourish' or, at least, to sustain sufficient profitability. This is certainly true with regard to the two big 'demand markets': sex and drugs. For example, the illegal drug trade has continued and the incentive for drug dealers remains, despite the fact that the price of drugs has declined since the 1980s (Van Duyne and Levi, 2005; UNODC, 2008; UNODC, 2009; UNODC 2010).[4] As a result of intensified health policies, certain crime-markets unfolded, like the illegal cigarette market. Consequently we witness an increase in cigarette smuggling in certain states which had introduced a higher tax in an attempt to support better health policies, deter smoking and collect more revenue from the cigarette smoking habit (Bartlett, 2002; Van Duyne, 2003; Von Lampe, 2006; Van Dijck, 2007; Van Duyne and Antonopoulos, 2009). The sex market never faltered, contributing to the mobility of thousands of women, many involuntary, but also many intentionally looking for the best place abroad to earn an income (Aromaa and Lehti, 2007; Spencer, 2007; Markovska and Moore, 2008; Siegel, 2009). Of course, this criminal mobility is accompanied by a commensurate financial mobility, *i.e.* laundering.

It may well be the case that somewhere there are oases which are clean of crime, but no society, whether developed or developing, socialist or capitalist, a totalitarian regime or democracy, has yet discovered the perfect vaccine against profit-oriented crime. Probably such a panacea does not exist at all as such crime, in addition to much of it largely being driven by greed, is also often related to two basic economic conditions: scarcity and price differences. One can strive for 100% virtue, but that is only attainable with a 100% penal dose and total control, which amounts to enforced virtue (see Van Duyne *et al.*, 2007c). Absolute virtue implies an absolute state.

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4 This trend, both for wholesale as well as 'street prices', appears to have continued in the past two decades to varying degrees and with certain ups and downs, depending on the type of drugs and geographical region. According to estimates provided by the UNODC, European street prices in 2008 were about half of what they were in 1990. However, purity-adjusted quarterly street prices for various drugs sold in Hong Kong grew between 2007 and 2009 (UNODC, 2010).

If criminal enrichment and theft have existed since the times of King Hammurabi or indeed, any other ancient ruler or mythical legislator, why is money laundering presented now as a new menacing phenomenon? What is so different today compared with the early days of modern capitalism, when the notion of money laundering remained un-labelled and robber barons like Carnegie or Vanderbilt freely reinvested their tainted money in powerful business empires (see Abadinsky, 2002)?

If, in the early days of modern capitalism, money laundering did not exist at all (or so it is believed), now it is cause for major international panic. Not only did money laundering emerge as a 'new' (political) phenomenon, it also proved to have different forms and shapes, being plugged into different definitions and attached to a range of other different phenomena such as globalisation and cross-border organised crime. Literature abounds with statements that money-laundering patterns have developed and become more sophisticated. Given that the police have always complained about criminals becoming increasingly clever, this observation is not surprising. Naturally, money-laundering schemes are embedded in their financial and economic cultural landscape, the complexity of which they mirror. They range from fairly simple to quite complicated schemes involving numerous banks and companies, often fictitious and often in offshore areas. Sometimes it proves too difficult to follow the money trails, especially in the context of financial worldwide money flows.

In response, policy makers and regulators have been looking for a global Panopticon[5] (see Gill, 2001; also Levi, 2002, p. 31) that would enable global financial control. Is the global Panopticon the much desired panacea against crime for profit? The search for a global Panopticon is, according to Gill (2001), a modern myth, undermined by the contradictions of globalisation. Hobbs and Dunninghan (1998), for instance, point out that one shortcoming of global-transnational-international studies of organised crime is the underestimation of the importance of local contexts. Indeed, while creating the global Panopticon we might be overlooking important differences in local contexts, including national legal frameworks, law enforcement systems, socio-economic environment, ethnic-cultural values and language. Interestingly, the same differences can impede the globalisation of crime and money laundering, as crimi-

5 The word originates from the Greek mythology and means something which sees everything. In modern days the Panopticon is a term that refers to a type of prison building the design of which allows an observer to observe all prisoners without them being able to recognise that they are being watched. The idea was developed by English philosopher and social theorist Jeremy Bentham in 1785 (see Bentham, in Bozovic (ed.), 1995).

nals have to become familiar with the local environment before they begin to operate there.

In order to ensure optimal and effective global financial control to curb profit-driven crime policy makers need to understand how, if at all, this globalising system of control affects the purported 'Achilles Heel' of criminals.

1.3. Purpose of this thesis

Policy makers and regulators claim that money laundering is a threat to society. One may wonder how this claim can be substantiated, given the virtual 'in-eradicableness' of this phenomenon: if it remains a threat today, so it should have been a century ago and by now we should be walking through the ruins of moral and financial decay.[6] It is claimed that money laundering allows criminals to enjoy their money. This applies to the present Colombian cartels the same way it should have applied to the old gang of 'Lucky' Luciano. It is also claimed that crime-money corrupts the financial system. The 'integrity of the financial system' is considered one of the basic dogmas underlying anti-money laundering policy. Whether the validity of this dogma is of a moral or empirical nature, it is difficult to determine. For an empirical test one should compare the financial systems of the periods prior to and after the introduction of anti-money laundering legislation. Unfortunately, neither FATF[7] reports nor any other literature that focuses on money laundering address this matter. It appears that this dogma is more of a *moral* nature than *empirically* substantiated. If money laundering conduct in broad terms led the financial system to ruin, it should be surprising that places such as Liechtenstein and Switzerland, historically known as financial havens, are still doing well. Tax evaders and other so-called criminals prefer to hide their money in banks in such places. Does it mean that these banks lack integrity or are in a financial ruin, given that even a rich criminal would certainly avoid trusting his hard-earned crime-money to a bank which is badly managed and lacks integrity?

It is widely believed that the process of globalisation and market liberalisation has enabled money launderers to easily shift and hide money across the

6 Around the time of finalising this thesis the financial system did indeed prove to be a hidden ruin. However, this was not due to sly and vile launderers, but owing to respected yet, as it appears, irresponsible bankers and a range of risks inherent to the free market, all of which in combination brought the market to a global economic crisis at the end of 2008 and early 2009.

7 The Financial Action Task Force on Money Laundering (FATF) is an inter-governmental body set up in 1989 to develop and promote anti-money laundering policies (the role of the FATF will be further touched upon in other sections of this thesis).

world. Yet globalisation also means a process of global streamlining of law enforcement efforts, improved international cooperation between national regulatory agencies and homogenisation of criminal justice systems across the world (see Alldridge, 2008).[8] While success is claimed this is yet to be proven. Why, despite enhanced global cooperation and globally coordinated efforts, do crime-entrepreneurs continue to find ways to earn money and consequently launder these revenues and enjoy their wealth? This is what regulators would have us believe: staggering amounts of dirty money are purportedly being laundered every year. However, there is little evidence to substantiate this claim despite some (methodologically unconvincing) attempts to provide such evidence (see for instance Walker, 1995; Walker, 2004[9]).

Undeniably, crime for profit continues, as far as we can observe. We can measure financial losses on the basis of registered property crimes and on that basis estimate the income of criminals. Although, rough estimates have been carried out to assess the profits from drug trafficking (Reuter and Greenfield, 2001), such estimates are normally based only on estimated criminal money making rather than precise figures. But can we *observe* money laundering? What we can observe, to an extent, is how offenders manage their illegal gains. However, this conduct of *crime-money management* is subsequently broadly construed as 'money laundering'.

In the last decade much attention has been devoted to 'transnational crime' and consequently to the related money flows. However, what happens with the crime-money that never crosses international borders? Does the management of crime money necessarily include taking advantage of global financial vehicles to escape regulatory scrutiny? Are money-laundering patterns in different local contexts the same or similar? Is it possible to measure the interaction between money laundering and globalisation? That question could only be answered if both terms, money laundering and globalisation, were clearly defined. These are two unclear terms and therefore with unknown implications.

Nevertheless, there appears to be a connection between the purported phenomenon of globalisation and the phenomenon of money laundering. This connection is multi-faceted and at least two main aspects of it can be noted. On the one hand, as highlighted above, globalisation can be seen as a process that

8 Nevertheless, there are still serious issues to be addressed with regard to the homogenisation of the various national systems where it concerns the rights of 'cross-border' victims (see Groenhuijsen and Pemberton, 2009; see also Letschert and Groenhuijsen, 2011).

9 Walker bases his analysis on: (a) a definition which is too broad, (b) unproven assumptions and (c) an uncalibrated measurement instrument.

has led to money laundering facilities, such as financial channels for shifting money across the world, becoming globally and easily available to criminals. Thus, it can be claimed that the process of globalisation *fosters* money laundering. On the other hand, law enforcement and regulatory efforts aimed at fighting money laundering are becoming increasingly globalised too. This is also part of globalisation. In this sense we can say that there are two opposite potential movements within the process of globalisation: it helps curb money laundering but it may also further its progress at the same time.[10]

The purpose of this thesis is to examine the applicability and adequacy of the legal term 'money laundering' in the context of an anti-money laundering system that is becoming increasingly globalised. How clear is the legal term that has been accepted internationally? Is its implementation empirically effective: is there an unambiguous purpose and is it being achieved? If the purpose is to curb crime for profit and related money laundering, is the anti-money laundering system built on solid grounds, *i.e.* on clear definitional basis, or is rather built on a constantly shifting platform similar to a Panopticon built on quicksand?

In order to address these issues, the thesis will review the background to and history of international anti-money laundering legislation, including the history of globalisation processes affecting the international world of economy and trade and developments which led to the introduction of anti-money laundering legislation. In addition it will study the origins of US anti-money laundering legislation as the driving force behind the introduction of international conventions and directives in this field (Chapters 2 and 3.1).

Further, it will examine the money laundering concept, both in its strict meaning and in broad terms, as defined by international conventions and directives, as well as the most common variations of the money laundering definition (Chapter 3.2). This thesis will also review the purported effects of crime money and money laundering, and the aspect of distinguishing between the various types of criminal earners and forms of financial management conduct (Chapter 3.3). Throughout the thesis, although the focus will be on the legislation of the USA and, most importantly, the resulting international conventions and directives, the analysis of the definitional basis will also include, where relevant, examples from the national legislation and legal practices of various countries around the world.

10 An interesting line of research could be looking into whether the cost of money laundering investigations weighs the two opposing forces differently.

Finally, this thesis will study the issues arising from the broad money laundering definition, including in terms of examining its link to the hidden economy and the bias towards developing countries. It will address the challenges facing the business community in meeting the requirements of anti-money laundering legislation (Chapter 4).

This thesis will test general assumptions and opinions that have, for many years, dominated and defined national and international policymaking. It will look for answers to unresolved issues relating to the fight against economic crime and money laundering and review the feasibility of addressing these issues on the basis of the relevant definitions as they stand now.

2. The globalisation phenomenon

This chapter will address the multidimensional facets of globalisation by analysing its meaning and contents. What is the underlying reality? Is 'globalisation' just a buzz word? The chapter will discuss the genesis of this purported phenomenon, its pre-history, connecting it to the opening of the boundaries of the transition economies to the outside modern capitalist world and linking it to the unclear phenomenon of money laundering. Developments in the transition economies[11] are interesting to review as the transition process was to bring the old socialist and capitalist worlds together into a truly globalised environment. What was the situation in the socialist world prior to the transition to market economy and what was it after that point in the context of money laundering?

2.1. General definition and semantic analysis

The usage of terms and the phenomena they intend to denote often come into the daily life of people as something taken for granted. We talk as if it is a matter of fact that we have 'instincts' and 'sub-consciousness', because psychologists like Freud have previously introduced these words with a somewhat unclear but appealing meaning. Sometimes we first coin a word and then assume that we know what it denotes, which is not far from the opening sentences of the Book of Saint John: "*First was the word and the word became flesh.*" Globalisation is a modern substantiation of this tendency and so is 'organised crime' (see Van Duyne, 1996; Von Lampe, 1999, 2001).

To many it seems quite clear what globalisation means. We believe we see it and sense it daily. People everywhere watch world-wide transmitted TV channels, use the internet and go to McDonalds. The big shopping malls in virtually all parts of the world look similar. The food and fashion culture, as well as the spread of information technologies illustrate how the world is becoming 'globalised'. If this sounds abstract, consider the millions of workers who globalise 'with their feet' by swarming around in search for work and income elsewhere. The term 'globalisation' is shorthand or a concise description of how different cultural, socio-economic, political units (nations, districts, cities) become more open to each other, more interactive, thus acquiring the

11 'Transition economies' or 'transition countries' is a term used to describe economies which are undergoing a change from a centrally planned economy to a free market economy.

same characteristics and beginning to look similar while sharing the same or similar values. Only certain features of the different societies have remained thus far distinctive, like religion and social relationship cultures.

It is the homogenising force of globalisation, as Fitzpatrick (2000) exclaims in reference to this phenomenon. Countries become increasingly integrated. Many policy makers within the European Union ('EU') believe that the EU is on the way to turning into a greased joint mechanism functioning on the basis of harmonised legislation, single currency and unified monetary system. In fact, the whole world seems to be moving in this direction. As Axford (2001) remarks, globalisation is a shorthand for a process that is making the world more interconnected and inter-dependent.

As we see, globalisation is a multi-faceted phenomenon but although its definitions vary broadly, they all unite around a common theme: the worldwide spread of certain characteristics or standards. The American Heritage Dictionary of the English Language (by Soukhanov, 1996) defines 'globalization'[12] (coming from 'globalize') as the process of making something global or worldwide in scope or application. Similarly, the Random House Dictionary of the English Language (by Flexner, 1987) states that 'globalization' comes from 'globalize', which means to extend to other or all parts of the globe or to make worldwide. According to this dictionary, the term 'globalise' emerged in 1940-45. In this regard one can say that it is a term that should have 'matured' by now in the sense of having obtained a well-defined meaning. Yet, there remains a questionmark over this.

As the Random House Dictionary of the English Language indicates, the term 'global village' – meaning the world, especially considered as the home of all nations and peoples living interdependently – was introduced in 1968 by the book "*War and Peace in the Global Village*" by Marshall McLuhan and Quentin Fiore. James and Albanese (2011) point out that the Oxford English Dictionary gives as the earliest reference to the current usage of the term 'globalisation' an academic article from 1972. They further note that the word had been used earlier, but in a different sense, *i.e.* as a diplomatic term referring to the connection between different policy areas (for instance, simultaneous negotiation on financial and security matters). According to James and Albanese, the first known reference to 'globalisation' in its contemporary sense was to be found in a 1970 issue of the radical left-wing Italian underground periodical *Sinistra Pro-*

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[12] The author of this thesis has used the US spelling of words only in relation to quotes from US sources.

letaria which published an article entitled "*The Process of Globalization of Capitalist Society*." It was a description of IBM as an organisation which 'globalises' all activity in the productive process and, as it produced in 14 countries and sold in 109, it contained the 'globalisation' (*mondializzazione*) of capitalist imperialism. The noun 'globalisation' began to be used in a more consistent way some years later, in the mid-1980s, when globalisation theory began to develop. According to James and Albanese (2011), the term 'globalisation' came to be commonly used in the 1990's reaching its highpoint of popularity in 2000 and 2001. They further note that the term 'globalisation' originated as a form of criticism against the political tendency it described but ended up being used even by the respective tendencies' proponents.

Tomlinson (1999) distinguishes two sociologists as the most outstanding theorists of globalisation: Roland Robertson, who was one of the first to use the term in a scientific-theoretical way in the mid-1980s; and Anthony Giddens, who connected the globalisation theory to social modernity.

Giddens (1990) highlights the inherent ability of modern societies to globalise mainly via the development of communication technologies. He describes the social relations as being taken out "*from local contexts of interactions"* and rearranged *"across indefinite spans of time-space*" (Giddens, 1990, p. 21). This process is to be distinguished from the process of internationalisation. Internationalisation means a process of intensifying relations between different sovereign states, but not necessarily subordinating national policies to supranational events and regulations (see Hirst and Thompson, 1996). Yet internationalisation is clearly a vehicle of globalisation, particularly when it furthers the mobility of people, trade and capital.

Hence, the term 'globalisation' is a general term with a complex underlying meaning, impossible to be linked to just one specific sphere of life. Although the origin of the phenomenon may well be connected to economic processes, the phenomenon encompasses far broader contexts – cultural, political, social and economic. As Tomlinson (1999) says, the term 'globalisation' has been quite loosely applied. But it undoubtedly epitomises an obvious tendency of introducing or adopting same or similar habits and standards world-wide, whereby the performance of a single state and society is being influenced by events outside its boundaries.

2.2. Implications of globalisation: old wine in new global casks

The fuzziness of the globalisation concept, however, arises not so much from its contents but rather from its implications: the consequences that the process of globalisation brings about may vary broadly. According to Axford (2001), globalisation generates positive developments. He believes that it has facilitated the spread of democratic values and practices around the world and that the fall of state socialism after 1989 provides the most dramatic evidence of this process. However, this representation may be overly positive. It cannot be denied that globalisation furthers the spread and accessibility of technologies. It implies easy access to high quality goods and services in the field of information technology. It also entails international tourism. But in terms of furthering international competition it appears that globalisation is more beneficial to advanced industrialised countries than to the developing world. In that respect it appears to have some negative impact as well. The fall of socialism may have been indeed facilitated by globalisation but it has not automatically ensured a level playing field and democracy. Globalisation is not a 'healing' phenomenon which washed away 'bad (governmental) habits'.

Developments in the former Soviet Union and the Eastern European block provide evidence of the shady side of globalisation with the collapse of state socialism. It appeared that these regions suffered soon from the spread of new forms of crime, cronyism in economic relations and endemic corruption. These manifestations of bad governance are not causally related to globalisation, but it appears that the regime change did unleash these abuses or took the 'lid from the pot' in which they had started to develop previously. Apart from that, numerous reports and official statements suggest that globalisation has an antagonising effect on some parts of society. For instance, according to the environmental activist Vandana Shiva (2000), the "*rules of globalisation are undermining the rules of justice and sustainability, of compassion and sharing*" and therefore we have to "*move from market totalitarianism to an earth democracy.*"[13]

Financial crises such as the credit crisis and financial market turmoil we witnessed in 2008, inevitably bear the signs of financial globalisation. The globally mutual investment in each other's derivatives, which proved to be mainly 'soap bubbles', underlines that globalisation has also uncontrollable negative consequences.

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13 The article was derived from an online source and therefore no page number is available.

Explaining the origins of the globalisation phenomenon, Jeffery (2002) notes that the anti-globalisation movement actually placed globalisation on the map. In the 1960s and 1970s multinational companies were blamed for widening the gap between rich and poor, for polluting the environment, and other 'evils'. However, anti-globalisation protests on a significantly larger scale began only in the mid-1980s. The wave of protests put the word 'globalisation' in the mouths of ordinary people who began to believe that something was happening to their life, that some kind of world order was being established by influential politicians and wealthy entrepreneurs who had the money to enjoy worldwide mobility. Therefore, there are reasons to associate globalisation with elitism, something the common man experienced happening to him. The words attributed to David Rockefeller, one of the world's richest-ever men, might not have come as a surprise to conspiracy theorists:

> "*But, the world is now more sophisticated and prepared to march towards a world government. The supranational sovereignty of an intellectual elite and world bankers is surely preferable to the national auto-determination practiced in past centuries*"[14] (quoted by Vizzutti, 2003, p. 105).

2.3. Prehistory of globalisation

Current processes of globalisation have their historic roots in the incessant mobility of the human race. Some of our first ancestors started moving from east to west and then from south to north settling down in lands favourable for agriculture and stock-breeding. Where they did not settle as agriculturists they spread the idea of using the soil and domesticated animals (Sykes, 2001). Forms of trade and exchange transactions began to develop gradually, including credit transactions and primitive forms of banking.[15] Banking received a boost during the time of the Roman Empire and re-emerged in Europe around the time of the Crusades when payments for supplies and equipment required safe and swift transferring of funds (Davies, 2002). In Rome, Venice and Genoa, and in the trade fairs of France, the need to transfer money for trade led to the devel-

14 He reportedly said this at a Bilderberger meeting in Baden-Baden, Germany, in 1991 (see Vizzutti, 2003).

15 Some forms of banking and credit transactions date back to the times before Hammurabi's Code. In fact, the invention of banking preceded that of coinage. It is believed that banking originated in Ancient Mesopotamia where temples provided places for safe-keeping of grain and other commodities. Receipts were invented to be used for transfers to depositors and third parties. Basic regulations of banking operations were included in Hammurabi's Code (see Davies, 2002).

opment of the use of financial instruments such as bills of exchange (see Davies, 2002).[16] During the Middle Ages, long distance trade became a form of globalisation (Dillard, 1967). The development of transport should not be underestimated, particularly transport over water. Particularly during the seventeenth century well equipped royal vessels as well as vessels of English buccaneers, Dutchmen and other North-western European nations, ventured to travel across the ocean in a quest for new fortunes and markets. Two circumstances contributed to their supremacy: the improvement of the sailing ships and the cannon. Indeed, the ocean ships became floating fortresses, for which there was no match in other maritime territories (Kennedy, 1991).[17]

In terms of geopolitical planning, we may say that the process of globalisation began slowly to develop in a more systematic way with the establishment of the first colonial, sea-borne empires (Boxer, 1973). It speeded up in the eighteenth and nineteenth centuries, when these, already powerful, empires expanded their territories and virtually carved up the globe, subjugating practically all territories except for a few, including China, Japan and Ethiopia. Colonisers imposed on other nations (often by exterminating the indigenous population) their own political-economic rules but also certain non-economic values, such as culture and (religious) traditions which proved to be the seeds of a not so globalising division of minds.

The process of globalisation was enormously boosted by the use of the steam engine in international transport: the train and steamship. This gave an unprecedented impetus to international trade. The invention of the steam engine marked the beginning of a new epoch in the development of human society, as Adam Smith believed. In the eighteenth century he was the one to proclaim the significant role of technical development and the real opportunities for gains from liberal economic relations and interdependence between national states (in his classic work "*The Wealth of Nations*"[18]).

A fully integrated world economy did not begin to appear until the second half of the nineteenth century (see Gill and Law, 1988). It was the time of industrialisation and crucial success of technical science. The transportation revo-

16 Davies (2002) notes that it is possible that such bills had been used by the Arabs in the eighth century and the Jews in the tenth, and that evidence exists that a contract was issued in Genoa in 1156 to enable two brothers who had borrowed 115 Genoese pounds to reimburse the bank's agents in Constantinople by paying them 460 bezants one month after their arrival.

17 The Western supremacy was facilitated by the withdrawal of the Chinese fleet from the western Indian Ocean in the 15th century, leaving space for the western traders, including Portuguese, English and Dutch (see Hok-Lam Chan, 2004; Chanda, 2007).

18 It is based on the complete 1904 edition of "An inquiry into the nature and causes of the wealth of nations" (see Smith, abridged edition of "The Wealth of Nations", 2010).

lution increased immensely the speed of communications in the nineteenth century. The invention and introduction of the telegraph and, later in the same century, of the telephone practically eliminated the distance barriers. The efficiency of the new means of communication far outmatched the slow and unreliable exchange of letters used between merchants in the 17th and 18th centuries. The widespread introduction of the telegraph in the 19th century led to the widespread use of wire transfers (see Davies, 2002).

The financial capital accumulated by the wealthy Western European nations began to quickly spread further afield in the form of colonial investment. As the main focus of this investment was in obtaining raw material, it involved the implementation of transportation infrastructure, thus contributing to the development of accompanying communication and railway construction.

2.4. The dawn of globalisation from the ashes of World War I

The use, progress and spread of means of communication and their international interconnectedness required the establishment of international treaties and organisations. Axford (2001) points out that between 1865 and 1910 thirty-three intergovernmental bodies were created, among which were the Universal Postal Union (1874) and the International Bureau on Weights and Measures (1875). The latter part of the 19th century and the early years of the 20th century also saw the establishment of the Permanent Court of Arbitration (1899)[19] and the International Association for Labour Legislation (1900). A significant international development was also the adoption of the gold standard in the late 19th century (see Davies, 2002).[20]

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19 The first permanent forum for political multilateral negotiations, prior to the establishment of the League of Nations (which will be mentioned later in this chapter), was the Inter-Parliamentary Union (IPU). The IPU is the international organisation of Parliaments, founded in 1889 at the initiative of two parliamentarians, William Randal Cremer (United Kingdom) and Frédéric Passy (France). The organisation was established to promote peace and international arbitration of conflicts and it played an important part in setting up the Permanent Court of Arbitration (PCA) in The Hague in 1899 (see IPU and PCA websites).

20 Although Britain had previously adopted the gold standard for the pound in 1816, other countries followed suit towards the end of the 19th century. In 1900, the USA also officially adopted the gold standard. With the outbreak of World War I a number of countries, including Britain, broke the link with gold and reintroduced it again some time after the war to break the link again during the Great Depression (mentioned further in this chapter), with Britain leaving the gold standard in 1931. The gold standard era finally ended in 1971 when the US authorities abandoned the system of fixed exchange rate and direct convertability of the dollar to gold (see Skidelsky, 1998; Davies, 2002).

Coinciding with this was the introduction of the first international treaties relating to the opium trade. During the 1840s and 1850s two so-called Opium Wars against China were fought. They ended in humiliating treaties between Britain and (later) France on the one hand, and China as the defeated country on the other hand. China was forced to open its ports to western trade, the main commodity of which was opium. These were the first enduring policy initiatives concerning the global drug trade. However, within seven decades these initiatives would become converted into a form of international police cooperation and globalisation of the penal law approach against (psychoactive) substances. The traffic of opium is a good example of early global trade between continents. But in the end it became an illegal global trade evoking an equally global penal law counter movement.[21]

At the beginning of the 20th century a large part of the world's industrial resources were concentrated in the British Empire. In 1900 it "*covered a quarter of the habitable globe*" and was the one among European countries that could be defined as a world power (Howard, 1998, p. 103). However, Germany managed to gain momentum and quickly became Britain's powerful economic rival with increased military potential. Germany's attempts to expand its power base led to a global and devastating war. Japan allied with France, Russia and the United Kingdom, while the latter engaged its dominions, Australia and Canada as well as South Africa. International neutral shipping was disrupted, while the German colonies spread over the African continent and Polynesia. To disrupt supplies from the USA to the allied powers, Germany launched unrestricted submarine warfare in the Atlantic Ocean against non-army ships (see Howard, 1998). This caused the entry of the USA into the European war (1917), which then became the first worldwide or global war – the First World War.

After the First World War, one of the first issues raised at the summit in Paris in January 1919 was about 'collective security', another dimension of globalisation. As a result, the League of Nations was established in 1920 to help keep peace world-wide through open negotiations that would replace "*the secret diplomacy of the discredited old order*" (Howard, 1998, p. 108). Under the aegis of

21 In some respect, this can be defined as the second truly global movement after the anti-slavery movement. As Van Duyne and Levi note (2005), it is rather paradoxical that the 'war on drugs' was preceded by 'Opium Wars' that were led for the sake of drug trafficking, namely the colonial trade to China. The first Opium War (1839-1842) started after the Chinese authorities tried to halt the import of opium from British India. As the export of this commodity was essential for maintaining a trade surplus with China, Britain reacted by occupying Chinese harbours (Van Duyne and Levi, 2005). As a result of the second Opium War (1856-1860), in which Britain was joined by France, China had to accept humiliating peace terms which included legalisation of the opium trade (Beeching, 1975; Van Duyne and Levi, 2005).

this organisation, in 1922 the Permanent Court of International Justice was created.

However, despite formulating the concept and signing the Covenant, the USA was not among the member-countries of the League.[22] The USA declined to join the League out of fears for its sovereignty (see Roberts, 1998). But they were members of certain special committees, such as the one on narcotic drugs. Furthermore, during the 1930s, eighteen other nations, including Germany, Japan, Italy and the Union of Soviet Socialist Republics (USSR), left the organisation or were expelled from it. This was a clear indication that the League was weak, as it had been from the very beginning. During the inter-war years the League failed to respond adequately to the Japanese invasion of Chinese Manchuria in 1931-32 (see Iriye, 1998; Skidelsky, 1998), to the Italian invasion of Abyssinia in 1935-36 (Skidelsky, 1998), and to the intervention by the Axis Powers in the Spanish Civil War in 1936-39 (see Howard, 1998).

The League was also not able to prevent the German rearmament, the occupation of Czechoslovakia and the invasion of Poland in 1939, which unleashed the Second World War. Neither could the Treaty of Rapallo of 1922, the Locarno Pact of 1925 and the Kellogg-Briand Pact of 1928 prevent this war. Prior to its outbreak, another event with a global impact contributed to the deterioration of international relations – the Wall Street Crash in 1929. It evolved into an unprecedented worldwide economic depression, known as the Great Depression (Galbraith, 1975).

"*The Great Depression of 1929-32 was the greatest peacetime breakdown of the world economy since the Industrial Revolution*" notes Skidelsky (1998, p. 55). The economic pressure led to the collapse of the gold standard system (previously mentioned) and consequently the multilateral clearing system. The short-term result of these events was the raising of tariffs and strengthening the control over international exchange. In a long-term perspective it led to the break up of the world trade order which had been established until that time and represented a step back from globalisation (see Skidelsky, 1998).

Despite the years of economic pressure, in the inter-war period, when the US became the main industrial power, its largest companies expanded their activities in other parts of the world, encouraged by the US 'Open Door' policy. Yet the 'open door' was not reciprocal: foreign firms had limited access to US markets and resources because of the US policy of protectionism. American

22 The League of Nations had 42 founding members. A further 21 countries joined between 1920 and 1937, but 7 left, withdrew or were expelled before 1946 when the League of Nations was dissolved (see Walters, 1960).

multinationals originally began to create world cartels, despite existing and newly introduced national anti-trust laws.[23] Then some multinational companies began to aspire to conquering the globe on their own instead of sharing the markets with rivals (see Vernon and Wortzel, 1980).

The progress of information and communication technologies continued between the two world wars. The radio-telephony or wireless transmission of voice, experimented in 1915 at the American Telephone and Telegraph Company, signalled the beginning of a transatlantic telephone service in the inter-war years and was followed by a rapid development of cable systems and communication satellites (see Porter, 1980). The achievement of Marconi in the late 1890s, the father of the wireless telegraphy,[24] and the work of other experimenters led to the development of international broadcasting industry. In the early 1930s the Radio Corporation of America began broadcasting signals corresponding to moving images (in monochrome)[25] (see Maddox, 1998). This was the beginning of a new era – the era of access to information and vision no matter whether you are at the centre of events or at the other end of the globe, and the era of international banking and money transmission, where money could move offshore or to any location in the world.

2.5. Globalisation and de-globalisation after World War II

The onset of the Second World War meant that all communications were severed, but a lesson was learned that nations had to be cemented into a global political system. This inevitably meant reducing protectionism and establishing international financial institutions and agreements such as the Bretton Woods agreement (see below).

After the Second World War previously interrupted developments were restored, furthered by the widespread use of new technologies. By the late 1960s worldwide television broadcasting as well as communication satellites had turned into a common thing for ordinary people. In the 1960s and 1970s the 'digital' electronic machines, created in the USA in the late 1930s, developed into unexpectedly powerful computers. In the late 1960s, researchers sponsored

23 The Sherman Antitrust Act of 1890 was the first United States federal law introduced to limit cartels and monopolies.

24 In 1896 Marconi was granted the world's first patent for a system of wireless telegraphy (Nobel Lectures, 1967).

25 Prior to that, General Electric Co., the British Broadcasting Company and other organisations began radio broadcasting of scanned pictures accompanied by sound (see Hogan, 1979).

by the US Department of Defense created the microprocessor ('chip') which enabled the production of modern personal computers. These developments gave an impetus to new technological companies, such as IBM, to produce and trade on a large scale (see Maddox, 1998).

The evolution of money continued as well, at full speed. While Britain and other countries had broken the link to gold during the global economic crisis in the early 1930s, the US kept the link to the gold standard and after the Second World War the US dollar replaced the British pound sterling as the key global currency (see Davies, 2002). Subsequently many countries fixed their exchange rates against the US dollar. However, as a result of growing international inflation, in the early 1970s this system of fixed exchange rates started to break down and the US abandoned the gold standard. This was later to contribute to the gradual development of intangible or e-money, especially from the 1990s onwards (see Davies, 2002), which was to make the shift of funds across the world so easy.

After the war, the aspirations of large businesses to become global became more evident than ever. The term 'multinational enterprise' emerged in the 1960s. Multinational enterprises were represented mainly by US companies which had gained momentum during the inter-war period (as mentioned in the previous section). However, multinational companies from other countries started gaining momentum too.

Multinationals spread their business culture and standards worldwide, thus acting as a vehicle of globalisation. Undoubtedly they contributed to the after-war world economic boom. The period between 1950 and 1973 was marked as the 'Golden Age'. The rapid economic development was also boosted by integrated supranational post-war politics. The Bretton Woods[26] Agreement of 1944 came as a "*compromise between the United States' new economic internationalism and Britain's demand for national autonomy to pursue full employment policies*" (Skidelsky, 1998, p. 58). The early post-war years also saw the emergence of the Organisation of the United Nations,[27] the North Atlantic Treaty Organisation, the European Economic Community, the International Monetary Fund,

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26 The Bretton Woods system was the international monetary framework of rules that prevailed from the end of World War II until the early 1970s. It was designed to govern currency relations among states at fixed, but adjustable exchange rates, with the International Monetary Fund (IMF) and World Bank playing a key role (see Skidelsky, 1998).

27 The United Nations Organisation in fact emerged out of an anti-Axis wartime military alliance which from 1942 onwards called itself the 'United Nations'. After the war, the new organisation took the same name (see Roberts, 1998).

the World Bank, the General Agreement on Tariffs and Trade and other international organisations.

The immediate post-war period, however, proved to also be a period of social and political turbulence as well as of a clear division between the capitalist and socialist world. This was to put a brake on the trend to globalisation for decades to come. The Korean War in 1950 - 53 (see West *et al.*, 2001) but even more so the Vietnam War in the 1960s antagonised many in the USA and abroad and led to anti-war protests. Additionally, various leftist, anti-imperialist, civil-right movements, uprisings against materialism, consumerism, and racial segregation demonstrated the level of public discontent with existing government policies and culture in the USA (see Patterson, 1996). This wave of social discontent spread to other parts of the world.

As mentioned earlier, in the 1960-70s, multinational companies also became the subject of widespread disapproval, being accused of concentrating power and capital in the hands of just a few influential entrepreneurs. Many began to regard the multinational companies and international organisations, created in the post-war period, as an instrument for the US to further their own interests and impose their own idea of capitalism on other nations (see Axford, 2001). After the Second World War the US became undoubtedly an economic world leader. Yet the Soviet Union emerged from the war as a powerful rival. It became a conductor of order and ideological concepts that were unwanted by the US (see Freedman, 1998). Stalin created a powerful state apparatus[28] and began the subjugation of the whole of Eastern Europe seeking to impose on them the Soviet concept of state and society. In response to the threat of a 'global communist conspiracy', the US issued the Truman Doctrine and elaborated the Marshall Plan to provide economic support to post-war Europe to contain the Soviets (Ambrose, 1993) by overcoming an economic breakdown of Western Europe and creating a strong anti-Soviet alliance. The underlying political objective of this aid was obvious to the Kremlin and they opposed it by establishing the Council of Mutual Economic Co-operation (COMECON) and the Warsaw Treaty. In the years to come, the trade and industry of the Central-Eastern European socialist bloc was to develop within the framework of the Warsaw Treaty and COMECON.

And here we have it: a division of the globe, as it had never been before. The 'Iron Curtain' symbolising the emerging global bipolarity was most visibly represented by the division of Germany. The clash between the different ideo-

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28 A process that had begun before the war.

logical systems of the socialist and capitalist blocs, and their ambitions to gain greater control in the world became notoriously known as the Cold War.

The political divide impeded globalisation. Over the years, the flow of goods, capital and people continued to expand but was still confined to certain parts of the globe on either side of the big divide.

2.6. Globalisation break-through after the fall of the Wall

Globalisation unfolded powerfully after the fall of the Berlin Wall in 1989, when its homogenising force began to spread from the capitalist world into the former socialist countries. It may well be that the collapse of the socialist economies was inevitable, but what happened after that crucial moment of the opening of borders, of letting globalisation spread capitalist attitudes and thus bring the 'benefits of a free market'?

It is true that democracy brought to the transition countries more freedom to speak, travel and trade but only to a certain extent. Various export quotas and visa regimes still impeded trade and travel, especially in the early years of transition. Globalisation manifested itself in various market-oriented reforms, not all of which had an immediate and positive impact. The free market policies of Milton Friedman applied as a 'shock-therapy' resulted in serious downside effects on the economy and society (see Stiglitz, 2002; Klein, 2007). It appears that the rules of liberalism proved largely to be the rules of money, serving corporate culture and the interests of multinational companies and powerful bankers (the credit crisis which unfolded in 2008 is also, to some extent, proof of this). The Western business culture and lifestyle began to influence the social and commercial life in the countries of transition (a process that can to an extent be described as Americanisation). Political developments showed that, in the minds of many, the Cold War was not quite over yet as the US and Russia appeared to continue to compete for world political domination, a process elsewhere defined as Cold Peace (see Bugajski, 2004).

The fall of the socialist regime in the East led to – sometimes illegal – mobility of people, which started haphazardly but soon unfolded along more organised lines, such that law enforcement agencies denoted it as 'organised crime'. However, the picture is very mixed. For example, woman trafficking ranges from the organisation of exploitative prostitution networks to young female fortune seekers (Maljevic, 2005; Aromaa and Lehti, 2007; Spencer, 2007; Gounev *et al.*, 2009). Some of these women, looking for a better life, wandered from Russia to as far as Israel to work in the sex industry (Siegel, 2009).

It also furthered commercial and financial globalisation which meant that the circulation of crime-money was largely unimpeded. However, the question was raised (but never properly researched) whether, and to what extent, these money flows contained loot derived through privatisation by the previous socialist elite, now converted to a new kind of robber capitalists. Criminal financial schemes abounded and continued relatively undisturbed (Baloun and Scheinost, 2002) including their return-flow as 'direct investment' (see Van Duyne and Donati, 2008).

As with other aspects of civilisation, the advantages of globalisation are not necessarily evenly distributed, nor are its effects necessarily beneficial. It appears that globalisation is fine as long as the rich can occupy the best parts of the globe and dump their welfare pollution elsewhere.[29] Some argue that legislation and courts' decisions globally are a variable which depends on the interests of those who control the big transnational corporations, which are stronger than some governments. According to these arguments, weaker states have no other alternative but to adapt and conform their policy to the world order dominated by transnational corporations (see Genov, interview in 2003). Tax laws, investment regulations and privatisation rules are often designed to benefit large businesses and transnational companies (TNCs), while smaller enterprises, especially in emerging markets, are being pushed into their shadow or even into the shadow economy. Transparency appears to have become a bargaining counter referred to only when it suits. Governments appear to focus more effort on what protects the interests of large corporations rather than what is truly good for the ordinary people.[30]

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29 See, for instance, media reports on the scandal of the Probo Koala ship, sailing from Amsterdam to the Ivory Coast, unloading a cargo of poisonous slobs, the processing of which was refused in Amsterdam. Reportedly in the summer of 2006, 16 people died in Ivory Coast's port city of Abidjan and thousands more became ill following the dumping of waste from the ship (see Braanker, *Radio Netherlands Worldwide*, 2008; for further details regarding this and other examples, see also Knauer *et al.*, *Spiegel*, 2006).

30 It can be argued, for instance, that the US Foreign Corrupt Practices Act, which will be touched upon in later sections (see section 4.4), was introduced in 1977 primarily to protect US commercial interests rather than to fight corrupt practices. Otherwise one may wonder how US government advisors who have pushed for the Iraq war agenda could have ended up with contracts for consultancy and reconstruction work in Iraq allocated to their own companies. When Becthel Group, which is known to have close links to the Bush administration, won a $680 million worth contract for the reconstruction of Iraq's infrastructure in April 2003, Democrats in Congress as well as European firms criticised the invitation-only contract awarding process. The *Guardian* noted that the US government claimed that the restriction is for practical reasons and that non-US firms will have the possibility to paricipate as subcontractors. The US government

The dictionary of the International Society for Ecology and Culture critically defines globalisation as: 1) the process by which governments give away the rights of their citizens in favour of speculative investors and transnational corporations; 2) the erosion of wages, social welfare standards and environmental regulations for the sake of international trade; 3) the world-wide imposition of a consumer monoculture (see Woodin and Lucas, 2004).

We must face the problem of social inequalities and poverty, as well as the growing threat of environmental catastrophe but can we blame all this on globalisation? Globalisation is not an agent, a 'being' doing things, but a process which is driven by human beings, their need to share and socialise and their need to reconnoitre new horizons for social as well as commercial objectives. As Williamson (2002) notes, no country can afford to remain isolated from the world economy: a complete autarky is hardly feasible. Wherever it was tried it resulted in impoverishment of the population as was the case with Germany before the Second World War, Albania in the late 1970s and, as it appears, North Korea at present.

Whatever the implications, globalisation is a historical fact. It is an irreversible process entailing both positive and negative developments, past and present. It affects trade of any kind, legal and illegal, as well as its related (criminal) finances. Therefore, returning to our subject, we have to face the fact that crime-money can now move anywhere across the world along with legitimate money flows fed by globally operating multinationals and global labour forces sending savings home. Given this background of globalisation processes can we take appropriate measures to curb the phenomenon of global crime-money movements?

2.7. Globalisation and money laundering

Globalisation should be considered a neutral empirical phenomenon: it is the confluence of historical developments. However, its effects are not neutral. As mentioned earlier, it entails not only positive but also negative developments, like 'globalisation of law breaking', as illustrated by the following example:

> In 1999 several senior officials of the Ministry of Sport and Tourism and the Senate Committee on Social Affairs in Brazil were denounced for having allegedly assisted the Mafia in distributing more than 20 thousand slot video

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also argued that their decision is comparable to EU policies (Burkeman, the *Guardian*, 2003; see also Roche and Silverstein, *Los Angeles Times*, 2004).

bingo machines. The alleged scheme took place at a time when the game was banned. It reportedly involved the Italian Mafia, including an alleged Mafia member named Lillo Rosario Lauricella. The criminal ring operated in two groups: one dealt with drug trafficking; the other focused on the financial management of the affair. The activities of the second group included the establishment of international vehicles for money laundering via banks in the USA, Spain, Brazil, Switzerland and Andorra (see Mingardi, 2001).

This example (among many others) illustrates how crime and crime-money management may expand beyond the territory of one specific country. Crime-entrepreneurs, similarly to their licit counterparts, respond to market incentives (see Mittelman and Johnston, 1999). In the context of globalisation this means that criminals may seek to use the advantages of the global market wherever they appear to be: in Brazil, Spain, the USA or elsewhere. Crime-entrepreneurs, as is the case with any entrepreneur, have always sought to bring the goods where there is a demand and an opportunity for a higher profit, balanced against risks. In a world of weak or inefficient border controls, liberalised trade and finances, crime-entrepreneurs can easily move to where price differences, corruption, legislative loopholes and ineffective law enforcement enable them to meet high yielding demand markets for contraband. The present peregrination of cocaine through Western Africa is an illustration of this global criminal flexibility (see Van Duyne and Levi, 2005).

This criminal flexibility enjoyed by crime-entrepreneurs is on a par with the continual trend of globalised law breaking by legitimate firms (for example, the on-going dumping of (toxic) waste and medicine in Africa). Indeed, existing 'regulatory asymmetries' such as differences in the regulation of offshore jurisdictions and onshore countries (see Adamoli, 2002) encourage licit entrepreneurs to do 'jurisdiction-shopping' and choose the jurisdiction which best suits them (see Van Duyne, 2002). The paths of licit entrepreneurs are soon followed by crime-entrepreneurs or vice versa.

Trade liberalisation, globalisation and the development of communication have increased the mobility of funds, including crime-money. According to policy papers, such as issued by the FATF and OECD (FATF-OECD Policy Brief, 1999) this is (supposed to be) a real threat to the global financial system. The hundreds of billions of crime-monies flowing through the arteries of this system are supposed to affect its integrity. However, according to other experts like Van Duyne and Levi (2005), estimates about the scope of crime-money management (or money laundering) are largely unreliable. They argue that these estimates only serve as an excuse to governments and international bodies to impose further measures of global control "*ranging from civil asset seizure and criminalization of association at home, to beating up on helpless island states and sending military advisors to burn down Andean peasants' huts ('cocaine labs') abroad*" (Naylor, 2002, p. 1; see also Harvey, 2003). Such flaws never hindered the anti-laundering proponents in their zeal to drive home the same moral theme. For example, the very fact that such monies can float anonymously and covertly within and between financial institutions is considered as a kind of abetting or even complicity to crime by those institutions. This is a token of 'lack of integrity' with a global impact, given the global financial system.

At this point the overarching framework of globalisation turns into an unbeatable every-thing-is-globally-connected-to-everything argumentation. Whether that is empirically correct does not matter: when the financial system is of a global nature, and who can deny that, then money laundering is global too. And consequently it is a global threat too.

This looks like a cast iron chain of reasoning, which should be more than a kind of semi-Aristotelean syllogism of which the Greek sophists would be jealous. But what do we have, apart from this anti-laundering sophism? We have a proclaimed threat of a purported global nature, supported by some mega estimates of questionable reliability and otherwise very little insight into the actual threat that has been posed by all this crime-money after the opening of borders, whether at its beginning in 1989 or twenty years later. Management theorists would note: what must be managed, needs first to be measured. But where the measurement of dirty money did not produce more than debatable results, one may question whether it is possible to assess and measure a more complex derivative: the process of spreading the money-laundering phenomenon globally. In doing so we face the difficulty of assessing the second derivative: the effects of the spread and enforcement of anti-money laundering policies across the world other than by counting the number of agencies which have been established. While acknowledging the importance of these questions, it must be noted that they are a methodologist's nightmare.

In the next chapter we will review the origin of money laundering, global anti-money laundering policy developments and some of the issues that arise from these developments.

3. The phenomenon of money laundering

3.1. Money laundering on the political agenda

In this chapter we will review the developments which placed money laundering on the political agenda. When did policy makers and legislators start paying attention to the money-laundering phenomenon and why did it take so long for them to notice it and raise the alarm?

3.1.1. Genesis of the money-laundering phenomenon

Prehistory

According to Morris-Cotteril (2001), money laundering is not a modern phenomenon. He quotes the historian Sterling Seagrave, author of "Lords of the Rim," who describes how, over 2000 years ago, Chinese merchants used various means, including purchasing movable assets and sending money abroad, to protect their wealth from the government. Seagrave writes that *"[o]nly those who remained invisible could expect to hold on to their wealth in the face of continual extortion by imperial eunuchs and bureaucrats*" (Seagrave, 1995, pp. 69). However, even if many of these merchants were greedy, engaged in "*predatory commerce*" (Seagrave, 1995, pp. 66-69) and working in conditions where risk-taking was condemned by Confucianism (Seagrave, 1995), they were seeking to conceal their wealth rather than conceal its origin. Illegitimacy of wealth is a key element in the concept of money laundering but indeed, as in the case of the ancient Chinese merchants, laundering techniques are often used protectively to hide one's wealth irrespective of its origin.

Uribe (2003) suggests that money laundering practices date back to at least the Middle Ages when moneylenders invented various mechanisms to cover up their evasion of laws which criminalised usury. Uribe also links the phenomenon of money laundering to the concealment of loot by the pirates of the Mediterranean who deprived Rome of its supplies but were defeated by Pompey in 67 BC. Uribe then describes the pirates who targeted European commercial vessels during the 16th-18th centuries as "*pioneers in the practice of laundering gold*" (Uribe, 2003, p. 1[31]). The comparison may well be appropriate, although there is no clear evidence that pirates' practices of laundering gold

[31] Page 1 of the online available pdf version.

ever went beyond the mere concealment of their loot and the bribing of local administrators. Some of them perhaps successfully pretended to be legitimate traders or managed to earn the status of privateers. Many pirates were able to legitimise their wealth with the support of British, French and Dutch governments[32] and some of them operated under a royal licence, although that would not constitute laundering the way we understand it nowadays. The phenomenon of laundering in the narrow sense of the term, *i.e.* providing a legitimate appearance to the loot, was yet to evolve.

Early preconditions

As reviewed earlier, hiding one's wealth, or, as we know it today, tax evasion, is an ancient phenomenon. Tax evasion techniques, involving the use of tax havens and offshore bank accounts, began to develop many years ago. Secret banking in Switzerland, for instance, dates back to at least the time of the French Revolution (Robinson, 2003; Taylor III, 1984) and by the end of the 19th century Switzerland had began to offer numbered accounts (Robinson, 2003). In 1932, a political scandal in France exposed the large scale of tax evasion and the use of secret Swiss banking by the French elite. The scandal became known as the 'Paris affair' or the 'Basler Handelsbank affair', after the name of the Swiss bank implicated in the matter. The French police discovered a list with about 2000 names of French citizens, including politicians, judges, bishops, generals and wealthy industrialists, who were hiding their money in Switzerland and who were denounced by the socialist deputy Fabien Albertin as tax evaders (see Hug, 2002; Komisar, 2003; Vogler, 2006). This demonstrates that the recent disclosures of Liechtenstein accounts have old ancestors.[33]

Over the years, tax evasion techniques improved, laying the foundations of today's money laundering (most of which, however, is technically still fairly

32 One of the most famous British pirates, Sir Francis Drake, was knighted by Queen Elisabeth I in 1581 and was appointed the second-in-command of the English fleet in the victorious battle against the Spanish Armada in 1588 (see Cummins, 1996; Turner, 2005; Kelsey, 1998).

33 The accounts were disclosed amidst a scandal involving hundreds of wealthy German tax evaders hiding millions in bank accounts in Liechtenstein. Reportedly Germany's intelligence service paid €4,2 million to an informant, a former employee of Liechtenstein banking group LGT, to provide the incriminating list of tax evaders allegedly stolen from LGT. The UK was also reported to have followed suit and paid a whistleblower £100.000 pounds (€132.931) for details of Liechtenstein accounts held by Britons after having originally refused to pay for the information.The scandal raised the issue about the ethics and accountability of the highly-paid business elite in Germany and elsewhere. However, it also sparked a debate about the manner in which the information was obtained and then shared with the authorities of other countries. A representative of LGT was quoted by the media describing these methods as illegal and extremely offensive (see reports by *Deutsche Welle*, 2008).

simple). However, although tax evasion techniques existed, the legal concept of money laundering, in terms of providing a legitimate appearance to ill-gotten gains, did not exist yet. In the second half of the 19^{th} century bank robbers like Jesse James did not need to launder their criminal profits (Hafner, 2002). They would simply leave the place of crime and go to another town to deposit the money. This money would be 'clean', as nobody would ask Jesse James where and how he had obtained his money (unless he was recognised). As the question was never raised, the concept of money laundering was of no relevance. There was no need for money laundering. Yet, in those days, the tainted money did flow through the legitimate system without any apparent devastating effects.

It was not until the early years of the 20^{th} century, when the US tax authorities began to require proof of legal earnings, that the concept of money laundering became relevant (see Anderson 1979; Von Lampe, 1999). Criminals had to justify their standard of living and for that purpose they resorted to money laundering, although the legal term was not yet introduced.

In April 1930, in the USA, the Chicago Crime Commission published a list of 28 notorious gangsters, with Al Capone leading the list. These gangsters were denounced as public enemies and the Commission required prosecution against them by all possible legal means (Von Lampe, 1999). The Commission's initiative was an essential development towards the personification of 'organised crime', as it referred not to the specific crimes of these gangsters but to their public status as criminals (Von Lampe, 1999). At this point of time it appeared less possible to prove any crime other than tax evasion. Prosecution for tax evasion became particularly effective after the US Supreme Court decided in 1927 that illegal earnings should also be subject to taxation (see Von Lampe, 1999). Following this ruling, in 1931 Al Capone became one of the first to be convicted of tax evasion and sent to jail.[34]

Saltmarsh (1990) notes that the term 'money laundering' is reputed to have originated from the 1920s, when gangsters like Al Capone and Bugsy Moran opened up laundrettes in Chicago to clean their 'dirty money'. It is possible that during the 1920-30s, the time of Al Capone, police officers coined the term 'money laundering' referring to criminals trying to justify their earnings,

34 Al Capone's brother, Ralph, was indicted on tax evasion charges too. Reportedly a week later after the indictment for tax evasion Al Capone and sixty-eight members of his gang were also charged with some 5000 violations of the Volstead Act (Prohibition), some of them going back to 1922. However, the tax cases took precedence over the Prohibition violations (see Bergreen, 1994).

specifically from alcohol trade during the Prohibition era.[35] Saltmarsh's view seems to be a suitable explanation of the semantic origin of the term 'money laundering'. Yet it somehow succumbs to the logic of what happened to Al Capone. He tried hard to cover his tracks – he reportedly used assumed names, never opened a bank account or acquired property assets in his own name, paid only in cash and tried not to sign anything. Given this background, it is difficult to believe that Al Capone might have thought of securing a legitimate appearance for his crime-money as prosecutors managed to demonstrate that he enjoyed a lavish lifestyle even though he claimed he had no income and never filed any tax returns. Additionally, they linked him to proceeds from a gambling operation. He was indicted with evading taxes of over $250.000 on unreported income for the period from 1924 to 1929 (Crumbley and Apostolou, 2007).

As Robinson (2003) notes, the legend about the laundrettes sounds more like a "*bedtime fable*" (p. 24). In any case, the rise and fall of Al Capone served as a lesson to his successors, who wished to avoid his fate. The next kingpins of the Italian-American Mafia or *La Cosa Nostra*, notorious criminals such as Luciano, Sindona and Lansky, decided it was high time to start managing their illegal money more efficiently, or so the legend says.

Lansky's groundwork

It is commonly believed that Lansky is the "*patron saint of money launderers*" (Blunden, 2001, p. 58), who took "*capital flight to the next level [. . . and] laid the groundwork*" for money laundering (Robinson, 2003, p. 24), including *organised* money laundering (Suendorf, 2001). Even the Australian Federal Police has posted on its website an article by Peter Huck (1997), which asserts that laundering was first conjured by Lansky. It appears that if we want to better understand the history of money laundering and its interconnectedness to globalisation, we will need to have a closer look at Lansky's track record.

A number of references suggest that Lansky laundered drug money (see McCoy, 1972; Suendorf, 2001; Scott, 2003; Robinson, 2003) and that he began mastering his laundering techniques soon after Al Capone's conviction (Blunden, 2001; Komisar, 2003; Robinson, 2003). McCoy (1972) even suggested that Lansky collaborated with the CIA in heroin distribution.[36] However, according to Lansky's biographer, Lacey (1991), throughout his adult

35 The Prohibition era lasted from 1920 to 1933.

36 McCoy also claims that at some point Lansky bought a Swiss bank, the Exchange and Investment bank in Geneva (see also Komisar, 2003; Scott, 2003).

years Lansky steered away from drugs, prostitution and murder. Yet Lacey admits that Lansky's associates were involved in all three. Thus Lansky's joint ventures were effectively a melting pot for money from the very same activities from which he allegedly stayed away. However, Lacey believes that Lansky was a money *manager* rather than a money *launderer*, in the strict sense of the term. According to Lacey, there is little evidence that numbered Swiss bank accounts began to be used by American criminals during the 1930s (Lacey also refers to Eisenberg *et al.*, 1979). Lacey makes a point that, at the time, it made no sense for Americans to transport cash across the world by steamer or railway when they could simply hide it in an unregulated local bank. Yet it should not have been difficult for Lansky to make wire transfers overseas. Western Union, for instance, already existed at the time. Lansky had reasons to be concerned about his money. Overseas tax havens must have been a better place for his savings than a local unregulated bank. While it is likely that Lansky gained the knowledge about tax evasion techniques from people who were intimately involved in that sort of operation,[37] it is difficult to believe that he would have waited until the 1960s to take advantage of the offshore world. But Lacey has a point that Lansky did not learn the craft overnight.

Lansky assumed the role of a crime-money organiser at quite an early stage in his career, during the Prohibition era. He learned how to work between legality and illegality from alleged criminal authorities such as Arnold Rothstein.[38] Lansky established a car rental business, which not only provided transportation for his bootlegging but also served as a legitimate front to his illegal activities (Lacey, 1991), which was not far removed from money laundering.

During the 1930s, after the end of the Prohibition era, when the profits from his bootlegging business could no longer be sustained, Lansky launched his gaming enterprise in Saratoga Springs and, later, in other places across the United States. According to Lacey, Lansky ran his gambling business through joint ventures in which his main role was to organise the share-out. At the time, gambling was largely illegal.[39] Nevertheless, casino gambling flourished.

37 Lacey believes that Lansky was introduced to the offshore world by associates, including former bootlegger John Pullman (who moved to Switzerland during the 1950s), and began to actively use offshore tax schemes during the 1960s, at a time of increasing pressure for more efficient tax collection.

38 During his early career Lansky worked for Rothstein who made his fortune in bootlegging and gambling, and managed to hide the dark side of his activities behind legitimate businesses such as real estate investments and Broadway shows (Lacey, 1991). According to Katcher (1994), Rothstein transformed organised crime into a vast business empire, run like a corporation.

39 Casino gambling was legal only in Nevada, which re-legalised casinos and other forms of gambling in 1931. The second state to legalise casino gambling was New Jersey, in 1976. By that

Lacey notes: "*Saratoga's month of summer indulgence operated on the basis of bribery and corruption*" (Lacey, 1991, p. 83). It appears that as a result of flourishing corruption Lansky and the likes perhaps did not need to worry too much about securing legitimate appearance to their wealth at that point.

In the late 1930s Lansky went to Cuba where, for the first time, he could manage his gambling operations in a legal fashion (Lacey, 1991). Lansky's investments in Cuba gave him the opportunity to legitimise some of his wealth. Robinson (2003) suggests that Lansky moved money from the US to Switzerland and back, both ways through Cuba, as a legal return on investments overseas.[40]

In the mid-1940s Lansky received his "*second great chance in his life to go legit*" (Lacey, 1991, p. 152). Jointly, with mobster Benjamin 'Bugsy' Siegel, Lacey invested in several projects, including the Flamingo Hotel Casino in Las Vegas where casino gambling was legal. The Flamingo was largely financed by the Mafia (see also Schott and Wilson, 1994). Yet Siegel's and Lansky's ultimate idea was more likely to have been to make a lucrative investment rather than to create a convenient money-laundering vehicle.[41]

During the 1940s Lansky launched also other legitimate enterprises such as Emby Distributing Company, a distributor of jukeboxes. But even these businesses were often operating in the "*grey area between hard-nosed tactics and illegality*" (Lacey, 1991, p. 169). Despite the illegality of much of his business, Lansky managed to run it relatively unimpeded until the early 1950s, when Senator Estes Kefauver launched his pursuit of the Mob and set up a committee (Special Senate Committee to Investigate Organized Crime in Interstate Commerce) to investigate the Mob's activities, including gambling.[42] In 1953 Lansky pleaded guilty to gambling charges. However, his sentence was hardly commensurate with the scale of his alleged crime.[43] He was sentenced to three months in prison and a fine of $2.500 (Lacey, 1991; Robinson, 2003).

point, especially during the 1930s and 1940s, other states had legalised only some forms of gambling such as low-stakes charity gambling and pari-mutual betting on horse races (see Rose, 1995).

40 According to Lacey, by 1960 Lansky had been listing his Cuban income in his official tax returns in the US.

41 It appears that Siegel was later killed by his backers who were unsatisfied with the way he managed their investment (Lacey, 1991; Schott and Wilson, 1994).

42 This was the first time organised crime firmly reappeared on the political agenda after Al Capone's conviction in 1931 (Von Lampe, 1999).

43 The light sentence could be explained by the fact that gambling businesses were largely tolerated and Lansky enjoyed protection from patrons in high society. Besides, investigators found little evidence to link Lansky to the gaming room in Saratoga (but proved his link to the restaurant

In the years to come, according to Lacey, neither the IRS nor FBI was able to identify any evidence that Lansky was laundering money offshore.[44] Yet Lacey admits that during the 1960s the IRS found evidence that Lansky was sending money overseas, in particular to Switzerland. Lacey notes that Lansky regarded his numbered Swiss account as "*an elaborate version of cash under the bed*" (Lacey, 1991, p. 305). Lacey highlights that there may well have been skilled Wall Street dealers who, during the 1960s and early 1970s, managed to bring their money 'full circle' back to the US via loan-back transactions in Switzerland or elsewhere. However, there was no evidence to suggest that Lansky was involved in such operations. According to Lacey, Lansky did not launder money as there was nothing to suggest that Lansky brought any laundered money back. However, this conclusion is arbitrary, as he may have brought money back undetected, in the name of his brother or nominee holders.[45] Lansky feared tax evasion charges and did everything to obscure the trail. Since the Kefauver investigation Lansky's tax returns had been scrupulously scrutinised by the IRS, which applied net-worth analysis to compare his declared income with his expenditure. For many years Lansky managed to remain unaffected. However, in 1973 he was eventually indicted on tax evasion charges.[46] But Lansky was let off the hook again.[47] In 1976 his indictment was dismissed.

What was Lansky's real wealth? According to Lacey, when in 1983 Lansky died, he left little to the surviving members of his family. Lacey notes that stories about Lansky's wealth, estimated at $300 million during his lifetime, were grossly exaggerated. But Lansky's $300 million myth survived for years. From Lacey's account it appears that Lansky was indeed "*a master of the casino skim*

that was part of the business). According to Lacey, Lansky agreed to plead guilty only in order to avoid further publicity and the possibility of incriminating others (Lacey, 1991).

44 Laundering was not criminalised yet but investigators were looking for international trails of hot money. Besides, after the Watergate scandal (see section 3.1.3. of this thesis), money laundering became a topical issue.

45 According to Lacey, Lansky's Cuban income ended in 1960 (after Fidel Castro overturned the regime of Batista) and since then Lansky had listed in his tax returns only American sources of revenue, including the Flamingo's finder's fee and dividends from oil and gas investments. Lansky feared extradition and, therefore, it is possible that he never brought money back as he intended to spend it abroad. If, however, any money was brought back, it could have been in the name of Lansky's relatives. According to Lacey, a substantial part of Lansky's business was in the name of his brother, Jake.

46 Prosecutors linked him to the tax evasion at the Flamingo through his legal finder's fee contract, which he so meticulously listed in his tax returns. During the 1960s tax evasion, in the form of skimming (the simplest form of which was removing cash from the counting room every night), was widespread (Lacey, 1991).

47 A crucial witness, Vincent Teresa, proved to be unreliable. Additionally, Lansky's health seriously deteriorated and he failed to appear in court on a number of occasions which impeded court proceedings (Lacey, 1991).

share-out" (Lacey, 1991, p. 386) but there is little evidence to suggest that he was involved in money laundering in the strict sense of the term (except for, perhaps, his Cuban investment return).[48] His tax evasion techniques, however, must have contributed to the development of the money-laundering phenomenon. But Lansky's story also shows that the human desire to pay less tax – shared by a host of tax payers– has been at the bottom of much of the anti-money laundering developments in the US and globally.

Hitler's loot

Perhaps the nearest to laundering in the strict sense of the term, in the years prior to the official recognition of the phenomenon, was the effort of Hitler's intelligence forces, not simply to conceal their loot but to present it as if it had a legitimate origin.

In order to buy supplies with the gold, which Hitler's officers plundered mainly from Jewish families during the Second World War, its origin had to be hidden. As gold bars were easily recognisable, Reichsbank officials decided to re-melt the gold. It was then shipped to Switzerland and other neutral countries to be used as collateral for credits. The gold was accompanied by fake documents that showed it had been legitimately acquired (Naylor, 1996; Smith, 1989).

Other pioneers in money laundering

Michele Sindona is also widely viewed as one of the pioneers in money laundering. Sindona studied law at the University of Messina and in his early career years worked as a tax lawyer, which allowed him to achieve a high level of sophistication in his later activities. He became known as an Italian financier, a former adviser of the Vatican Bank, but most importantly as the banker of the Italian Mafia. In this capacity he became involved in the management of the money of crime-families in Italy and the US, and the financing of their "*hidden political monopolies*" (Rossetti, 2003, p. 83).

When Sindona decided to leave Italy in 1971, he left behind a well-established network of shell companies and banks, including offshore. This network was inherited by Roberto Calvi, who was appointed general director of Banco Ambrosiano in 1971 and President of the bank in 1975. Banco Ambrosiano was founded in 1896 to serve the interests of part of the Lombard Catholic bourgeoisie. The bank acquired international notoriety after its dra-

48 This does not exclude the possibility that he laundered the money of other mobsters.

matic demise, caused by dubious transactions and the fall of the dollar. Having managed to flee from prosecution, Calvi was found hanging under Blackfriars Bridge in London in 1982. The bank was declared bankrupt a few weeks later. According to investigators, Calvi's expansion strategy, designed with Sindona's assistance, had brought the bank to its collapse. The bank had become a major provider of illicit financial services, such as money laundering and loan-sharking to powerful Mafia clans and freemasonic lodges as well as to minor criminals (see Cornwell, 1983; Paoli, 1995).[49] It illustrates that affluent criminals have little to gain by undermining the integrity of the financial system, putting their monies at risk as well.

During the 1970s another criminal scheme in the banking sector took place. The Australian Nugan Hand Bank was used by drug and arms dealers for money laundering and other illicit financial operations in 13 countries (see Common-wealth-New South Wales Joint Task Force on Drug Trafficking, 1983). There was also evidence to suggest that high-ranking US military and intelligence officers, particularly from the CIA, had links to the bank and were implicated in the bank's highly questionable dealings (Kwitny, 1987; *New York Times*, 8 March 1987). It was also reported that one of the main organisers committed suicide or died under suspicious circumstances (*New York Times*, 8 March 1987).

The financial empire of the notorious BBCI was also established during the 1970s. As Truell and Gurwin note (1992), "*BCCI's role as a dirty money machine came naturally [. . .]. BBCI's most unscrupulous bankers were often the best marketers, since they did not hesitate to handle dirty money*" (p. 169). However, it appears that the BCCI was not established as a money-laundering bank or a bank for dirty money. The BCCI was a badly managed and ill-supervised bank, which eventually faced serious deficits. This made it susceptible to all sorts of deposits to stop the gaps. This raises the question whether lack of efficiency and integrity

49 In the meantime, Sindona continued his activities out of America. His fate was no less dramatic than Calvi's. In 1972 he bought a controlling stake in Franklin National Bank, in Long Island, New York. In 1974 the bank collapsed amidst allegations of large-scale financial speculation, mismanagement and fraud. This also affected his banking interests in Italy, where the Italian lawyer Giorgio Ambrosoli became the liquidator of his banks. In 1979 Ambrosoli was murdered. In 1980 Sindona was convicted in the US on 65 counts of conspiracy, fraud and perjury in connection with the collapse of the Franklin National Bank. He was sentenced to 25 years imprisonment but was later extradited to Italy where, in 1986, he was convicted for arranging Ambrosoli's murder. In 1986, in prison, Sindona was poisoned with cyanide (the matter was covered by the press: *Time Magazine*, 7 April, 1980, also Dionne, *The New York Times*, 22 March 1986). Laundering can be bad for one's health.

are actually *preceding* laundering instead of laundering as a *cause* of eroded integrity.

These examples illustrate that by the 1970s the money-laundering phenomenon had already began to emerge in some form in many places in the financial system. Rather, because it was connected to other forms of financial wrong-doing (*e.g.* fraud, currency violation, embezzlement), it was increasingly coming to the surface and recognised as such. As long as bankers do not create scandals, their laundering is more likely to go unnoticed.

Some authors (see for instance McCoy, 1972; Chambliss, 1988) argue that during those years, alongside the Mafia, governments became also involved in some forms of illicit operations and money laundering and, while doing so, contributing to the emergence of various money laundering techniques (see references to Nugan Hand Bank above). Chambliss (1988) for instance talks about 'state-organised crimes' or, in other words, illegal acts committed by state or government officials in the pursuit of their official job. A number of authors provide examples of illegal covert operations allegedly conducted by the US Central Intelligence Agency (CIA) (see Lernoux, 1984; Chambliss, 1988; Bainerman, 1992; Brewton, 1992; Simon and Eitzen, 1993; Robinson, 1994; Blum, 1995). The CIA was established in 1947 and since the early years of its existence it has been linked to controversial and covert activities for which it needed funds.[50] However, if the funds of the CIA were of licit origin, they would not need laundering, or perhaps 'inverse laundering'. Likewise, if the CIA has used illegal funds for illegal operations, these funds would not need to be legitimised either. On the other hand, when legal funds are used for illegal purposes, they become tainted. But transactions with tainted money do not necessarily constitute money laundering (in the strict meaning of the word), though these transactions must be dressed up in such a way that their illegality remains covered. And does the handling of money after the 'dip in the dark' not qualify as laundering?

As we see, the term 'money laundering' began to be widely equated with the full range of money-laundering *techniques*, although such techniques may also be used for hiding legitimately acquired assets. (For instance, Walter (1991) refers to hiding assets in alimony law suits, heritage disputes and other civil disputes about money, which explains the need for a 'financial secrecy industry'

50 The CIA was alleged to have conspired to create the coup d'état in Iran in 1953 and to have financed it with laundered money (see Robinson, 1994). Numerous references on the internet claim that the CIA has been involved in similar events in other countries (including Guatemala, Cuba, Chile).

also for licit matters.) This overlap or, to an extent, confusion, continued despite, or even because of, legislative developments and the emergence of official, legal definitions of money laundering.

3.1.2. Early legislative developments

The USA has undoubtedly been the main driving force behind the introduction of anti-money laundering regulations worldwide and the establishment of Financial Intelligence Units (FIUs).[51] The Financial Record-Keeping and Reporting of Currency and Foreign Transactions Act of 1970, known as the Bank Secrecy Act (BSA),[52] constituted the first comprehensive American anti-money laundering law. The Act did not explicitly contain the term 'money laundering' and neither did subsequent regulations of 1972[53] and of 1977.[54] However, the Act was introduced to target crime-money concealment and laundering, but, in the main, tax evasion. It stipulated that financial institutions maintain records and file reports so as to enable law enforcement authorities to track financial transactions in criminal, fiscal or regulatory investigations. Basically the Act established a financial intelligence tool, the effectiveness of which has remained a question.

In 1970 the US enacted the Racketeer Influenced and Corrupt Organizations (RICO) Statute as title IX of the Organized Crime Control Act of 1970.[55] The RICO-Statute played an important role in the context of future anti-money laundering regulations as it was designed to prevent criminals from infiltrating legal enterprises and to prosecute criminals who had already acquired a share of the legal economy (Von Lampe, 1999). The RICO-Statute and other laws and regulations that were introduced in the 1970s and 1980s were ultimately aimed at assisting law enforcement agencies in confiscating the proceeds of crime. Such a process was observed internationally. As Stessens (2000) notes, law enforcement authorities needed a more effective legal instrument to fight crime and ensure that criminals were deprived of their illegal profits. Stessens further notes that while the majority of criminal justice systems were familiar with the more traditional forms of confiscation, namely, the con-

51 Acronym for government bodies responsible for anti-money laundering compliance. The development of the international network of FIUs will be discussed in more detail in another section.
52 31 U.S.C.1051 et seq.
53 Sec. 103.23 Reports of transportation of currency and monetary instruments.
54 Sec. 103.24 Reports of foreign accounts.
55 RICO is codified as Chapter 96 of Title 18 of the United States Code, 18 U.S.C. § 1961–1968.

fiscation – often known as forfeiture – of the instruments (*instrumentum sceleris*) or the subject of crime (*objectum sceleris*), they did not necessarily provide effective instruments for the confiscation of the proceeds from crime (*producta/fructa sceleris*) and this gap was mostly observed in proceedings against drug traffickers. However, to an extent, as a result of these new laws and regulations, criminals felt urged to begin more actively diversifying their activities through infiltrating the legal economy in order to protect their ill-gotten assets (see Von Lampe, 1999). If this assertion holds true, we have the paradox that these legislative developments not only failed to kill the money-laundering phenomenon at its earliest stage of development, but in fact furthered its expansion and sophistication. We will see whether there is sufficient evidence for this claim.

3.1.3. First published use of the term 'money laundering': Watergate

The events involving Al Capone and other underworld figures in the 1920s and 1930s prepared the stage for the emergence of legendary tax evaders and pioneers in money laundering such as Lansky and Sindona described earlier. As mentioned in the previous chapter, the term 'money laundering' may well have been coined some time during the 1920s, during the Prohibition era. It is also likely that metaphors conveying a similar meaning were used during that period. For instance, a reference posted on http://www.wordorigins.org/index.php, a website which studies the origin of words, provides the following citation from the San Francisco Call-Bulletin (now San Francisco Examiner) of 3 June 1935: "*There is not a hot money passer in America who will "wash" this money exchanging it for "cool" currency - unless it is offered him at such a tremendous discount that he can afford to hold it for years, if necessary, before attempting to pass it.*"[56]

However, although the previous chapter elaborated on the old history of money laundering techniques by renowned pioneers (*e.g.* by Lansky, Sindona, and allegedly intelligence agencies, specifically the CIA), it was not until the 1970s, at the time of the Watergate scandal, that the money-laundering phenomenon was recognised and named as such. The first public use of the expression 'money laundering' can be traced back to 1972-73 when it appeared in printed media during the Watergate scandal (Lacey, 1991; Gilmore, 1993[57];

56 The reference was posted by Wilton (2007) who quotes Safire (1993, p. 398) as the source of the San Francisco Call-Bulletin citation.

57 Gillmore (1993) makes a reference to Vallance (1992).

Robinson, 1994; Blunden, 2001).[58] The term was first used in a judicial context in 1982 in the case US v $4, 255, 625.39 (1982) 551 F Supp 314, and it subsequently spread worldwide (Gilmore, 1993).

The Watergate scandal was a crucial moment in the history of money laundering. It exposed high-level political corruption and implicated the CIA in highly questionable dealings.

> In the morning of 17 June 1972, the police caught five burglars inside the Democratic National Committee headquarters. They were there to take pictures of documents and adjust bugging devices that had been installed during an earlier break-in in May the same year. The burglars had reportedly been sent by Nixon and were acting on the orders of CREEP (Committee to Re-elect the President). One of the burglars was James McCord who had a long CIA work record. CREEP was later accused of 'laundering' President Nixon's illegal campaign funds. The Committee was also alleged to have financed its activities via a CIA's front company (see Blum, 1995, and Steve Kangas,[59] 1996). Maurice Stans, Secretary of Trade at the time,

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58 According to the Oxford English Dictionary (1989, second edition), the first use in print of the term 'money laundering' was during the Watergate scandal. The Dictionary cites a *Guardian* article of 19 April 1973 which reported: "*Suitcases stuffed with 200,000 dollars of Republican campaign funds; money being "laundered" in Mexico*." A number of earlier references have been cited on the internet (see the website of Barry Popik, 29 June 2010, quoting Google News Acrhive): (i) 1 September 1972, *Milwaukee (WI) Journal*, "Outside Investigator Needed" (editorial), pg. 16, col. 2: "*They are worried about the way much of the $114,--- was first "laundered" in Mexico—that is, checks were deposited in a Mexican bank account and converted into dollar drafts so donors could remain unnamed*."; (ii) 13 September 1972, *Daytona Beach (FL) Morning Journal*, "Money As A Campaign Issue" (editorial), pg. 4, col. 1: "*Money could be a prime issue in the 1972 campaign, the National Observer notes. Succinctly, one of its top political writers said: "Remember: ITT, Watergate, the dairy lobby, tales of contributions being 'laundered' in Mexico, a safe full of $350,000 in cash. All of this, and much more, proves the point*."; (iii) 13 October 1972, *Albuquerque (NM) Tribune*, "Watergate case compared to capers of GOP-bugging prankster Tuck" by William Steif, pg. B4, col. 5: "*I would have hired an armored truck for $60 in San Antonio," said Tuck, "and sent it to the ranch to pick up the money. And I would have had a laundry truck following it—to launder the money*."; (iv) 12 April 1973, *Lakeland (FL) Ledger*, "Reelection Became Boyish Fantasy" by Russell Baker, pg. 1D, col. 4: "*Whether the stachel full of cash, the Mexican money-laundering operation, the Arab bazaar in Ambassadorships—whether these seem to be symptoms of a new low in political rot or merely low comedy in slightly bad taste will depend on the observer's political bias*."; (v) 12 May 1973, The Bulletin (Bend, OR), "Adviser Connally leaves Texas law firm to avoid possible conflict of interest," pg. 7, col. 6: "*Newsday said that he identified the money as his own "personal" contribution after federal investigators uncovered the Mexican "money-laundering" scheme*."

59 Steve Kangas, a former Army intelligence officer, who described himself as a liberal, became widely known for maintaining a web page, "Liberalism Resurgent," on which he criticised the conservative causes. A frequent target of his attacks was billionaire publisher Richard Mellon Scaife. He also wrote about the CIA and claimed that it played a significant role in creating an 'overclass' in which Kangas included Scaife. In 1999 Kangas was found dead. He was alleged to have committed suicide. Although not everyone viewed his writings seriously (see Tony Snow,

became responsible for CREEP's financial operations. In 1971 they started fuelling funds into the President's treasury in secret. Donors reportedly included representatives of the US dairy industry who wanted to reward Nixon for raising federal subsidies; multi-millionaire Howard Hughes; also Robert Vesco who at that time was under investigation for alleged embezzlement; American Airlines, Ashland Oil and Gulf Oil. The donations of the latter three were allegedly laundered money derived from fraud and other offences (Robinson, 1994).

Reportedly the underhand practices orchestrated by CREEP involved illegal wiretapping and break-ins and subsequent cover-ups, audit irregularities, political sabotage and conspiracy as well as financial scams aimed at concealing the origin of the campaign funds which was effectively a campaign fraud. Even money from legitimate sources would have become tainted when in contact with so much illegality.

While the whole operation may not have been exactly money laundering in the narrow sense of the term, it certainly involved what we view today as classic laundering *techniques*. But it was not the Watergate scandal that urged policy makers to start paying attention to the money-laundering phenomenon.

3.1.4. Circumstances that shifted attention to money laundering

The war on drugs

Global trends were dictated by developments in the USA where, during the 1980s, illicit drug trade became the main target of law enforcement.

While during the 1970s organised crime in the USA attracted relatively less public attention, in 1983 it again became the centre of growing concern and interest due to two main factors: the RICO-Statute began to be rigorously applied against members of *La Cosa Nostra*; and between 1983 and 1986 the Commission on Organized Crime, established by president Reagan, unfolded an active anti-crime campaign which targeted illicit drug trade (see Von Lampe, 1998).

An important document introduced by the US government during that period was the Organized Crime Drug Enforcement Task Force Program adopted in 1982 (Wisotsky, 1990). This document contained measures which turned the war against 'organised crime' into a 'war on drugs' (see Von Lampe,

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"Life and death on the lunatic fringe", *The Star-Ledger Newark*, 23 March 1999), many believed in what Kangas said and, after his death, founded mirror sites to recreate his essays.

1999; see also Del Olmo, 1991; Bullington, 1993; Bertram *et al.*, 1996). According to this document, the 'war on drugs' became the prerogative of the FBI and the DEA (Drug Enforcement Administration) (Wisotsky, 1990; see also Von Lampe, 1999). The DEA was established in 1973 as a successor of the Bureau of Narcotics at the Treasury Department which was dissolved in 1968 (Wisotsky, 1990; Von Lampe, 1999; Abadinsky, 2002). During those years it became clear that the war on drugs was to become a priority on the agenda of policy makers, although drug consumption had been a problem for decades.

Earlier developments that led to the war on drugs

The history of drug control policies dates back to at least the end of the 19th century, at the time of the Industrial Revolution, when opium products began to be widely used as a panacea against all sorts of diseases ranging from a sore throat to cholera.[60] According to Laniel (1999):

> "*It is no exaggeration to say that as far as the modern drug phenomenon is concerned, the United States is where it all started in the late 19th century and early 20th century. Indeed, the present legislation of the majority of countries is modelled on, or in agreement with, international legislation, which is itself inspired to a large extent on the American drug control model.*"[61]

The first legislative step taken to limit the use of drugs was the introduction of restrictions on import and trade in opium in the 1880s. These restrictions targeted ethnic minorities, specifically Chinese, but later also Mexicans and African-Americans (see Laniel, 1999). During the 19th century, immigrants became a major part of the working classes in the USA. Naturally anti-drugs policies, specifically the criminalisation of "*the bad habits of 'non-Americans'*," had an element of xenophobia (see Van Duyne and Levi, 2005, p. 11) and white Anglo-Saxon fundamentalism which condemned every worldly pleasure, including drinking, sex and gambling, as sin. Yet there were indeed serious issues relating to drugs use that needed to be addressed. Medics were concerned about the use of psychoactive substances in the production of certain consumer goods, for instance wines and sodas laced with cocaine or heroin-based cough syrups (Laniel, 1999). The danger that consumption of such commercial products

60 The medical definition of 'addiction' as a disease-like condition was first developed for 'habitual drunkenness' in the late 18th century. During the 19th century the concept was broadened to include the use of 'illegal drugs' mainly due to the concern about the increasing use of opiates by American Civil War veterans and middle-to-upper class white women (see Levine, 1978; Parssinen, 1983; Courtwright, 1982; Laniel, 1999).

61 Section "The United States and the MOST-Drugs Network", second paragraph (no page number available as the paper was derived from online sources).

could lead to drugs abuse habits was a serious issue. Concerns were additionally fuelled by reports about increasing drugs-induced violence (Van Duyne and Levi, 2005; ch. 2). These concerns led to the adoption of the first important drug-related federal act, Pure Food and Drug Act, in 1906. The law required that labels of goods indicate whether the product contains any psychoactive ingredients.

However, US policy makers were not satisfied. What they really sought to achieve was not 'soft' reduction but outright prohibition, ideally not just in the USA but internationally. This inevitably was to have an impact on the interests of colonial powers such as the Netherlands, France and Britain (McCoy, 1972; Gerritsen, 1993; Van Duyne and Levi, 2005). By lobbying "*continually and forcefully around the world*" the US authorities sought to achieve its domestic control objectives (Sinha, 2001, p. 9) while turning its domestic drug issue into a global problem, thus effectively 'exporting' the war on drugs (Friman, 1996; Van Duyne and Levi, 2005). Reportedly, in order to ensure justification for prohibition policies in the USA and internationally, Hamilton Wright, a US delegate to the Shanghai Opium Commission in 1908, presented a deliberately inflated number of addicts (Van Duyne and Levi, 2005). Wright did so, despite evidence that opiates consumption had in fact decreased during the previous decade (Courtwright, 1982), because he strove to achieve his ultimate aim: the 1912 Opium Treaty[62] of the Hague which introduced the international prohibition of all opiates and cocaine (Van Duyne and Levi, 2005). The 1912 Treaty helped Wright to push further for domestic US legislation (Sinha, 2001). Shortly after the international treaty was signed, the USA introduced its second major federal statute: the Harrison Narcotics Act of 1914, which taxed the trade in opiates and required opiates and cocaine to be supplied only on medical prescription. The Act effectively banned the free sale of opiates. As the Treasury Department was responsible for the enforcement of this act, by 1920, it had developed a special department, the Narcotics Division of the Prohibition Unit, to deal with related issues. In July 1930, the Narcotics Division was transformed into the Federal Bureau of Narcotics, which (as mentioned earlier) was later succeeded by the DEA.

The restrictions on trade in opium and cocaine, and the subsequent bans on heroin in the 1920s, and marijuana in the late 1930s, combined with the increasing demand for these substances, naturally led to the development of illicit

62 The treaty was signed in 1912 but came into force in 1919 with the Treaty of Versailles, which ended the First World War. The treaty became also known as International Opium Convention or the Hague Convention.

production and an underground drugs market (Van Duyne and Levi, 2005). During the 1960s illegal drug trade became a serious problem largely because in the quickly developing new youth culture drugs consumption became widespread (at least as far as cannabis products were concerned). This raised questions about the effectiveness of prohibitionist policies and led to a worldwide debate about the causal connection between the use of drugs and crime (see Rasmussen and Benson, 1994; Pieth, 1999; Van Duyne and Levi, 2005).

It appeared that the USA had not only dealt with its problems short-sightedly but had also imposed its ineffective solutions on other nations (Van Duyne and Levi, 2005). According to Pieth (1999), despite rigorous drug control measures, in the second half of the 1980s, the illicit drug situation had deteriorated, especially in the US. Pieth notes: "*The traditional prohibition policy, trying to climb from the street vendors up the chain of dealers to the bosses, had obviously failed, the influx of drugs had grown further and the number of dependants had multiplied*" (Pieth, 1999; pp. 530-531). It took long for policy-makers and law enforcement officers to realise that it was not enough to arrest the Mafia bosses to prevent illicit drug trade because "*if we cut off the head of the hydra, another one will grow up quickly*"[63] (Hafner, 2002, p. 21).

In order to achieve greater effectiveness, policy-makers had to take a new approach to the war on drugs. It was suggested, as mentioned previously, that drug dealers should be hit in their pocket and that this could be achieved through confiscation of assets and criminalisation of laundering the proceeds from drug trafficking (see Pieth, 1999; Stessens, 2000; Hafner, 2002; Van Duyne and Levi, 2005). Although, as reviewed in the previous chapter, anti-money laundering measures could have been implemented much earlier, during the 1970s, to support the ineffective Bank Secrecy Act, it was during the 1980s, that the US authorities apparently saw the need for an anti-money laundering regime. The first US federal law which criminalised money laundering, the Money Laundering Control Act, came into force in 1986, as part of the Anti-Drug Abuse Act. The Anti-Drug Abuse Act of 1986[64] (passed in 1984) created the offence of "money laundering", which is chargeable as a violation of 18 U.S.C. §1956 (Sec. 1956. Laundering of monetary instruments) or 18 U.S.C. §1957 (Sec. 1957. Engaging in monetary transactions in property derived from specified unlawful activity). It enhanced the Bank Secrecy Act essentially by making it a crime to structure transactions in such a way as to avoid

63 Translated from German.
64 Pub.L. No. 99-570.

BSA's reporting requirements. The war on drugs appeared to be a good cause for declaring a war on money laundering. But was anti-money laundering legislation really driven by the desire to reduce drugs consumption? Meanwhile the US administration began to prepare the international community, through the United Nations, to adopt a more severe attitude to drugs and related money laundering. In the resolution of the 7th United Nations Congress on the Prevention of Crime and the Treatment of Offenders in 1985, it introduced the fight against drug trafficking and drug abuse as 'imperative'. Also a section on money laundering was introduced, containing the basic outlines of the later anti-money laundering regime (Van Duyne and Nelemans, 2011).

3.1.5. Confluence of other motives behind anti-laundering policies

On 18 September 1989, the *Washington Post* reporter Jack Anderson wrote about a drug cartel that was turning into a clandestine superpower threatening the security of the USA. He called upon the US government to exercise pressure on other states in order to urge them to adopt drug money confiscation provisions.

However, some observers have questioned the veracity of US official motives to introduce asset confiscation and criminalisation of drug proceeds laundering. According to Hafner (2002), the US government would hardly dare to attack, directly and overtly, tax-evading by large businesses and wealthy citizens (at least at the time it appeared so, but the recent case of UBS, see below, demonstrates a changed attitude), but could easily pry into their pockets under the cover of chasing drug money. Indeed, who could say 'no' to the lofty aim of confiscating the proceeds of drug traffickers? Once the principle was accepted for 'serious' offences, it could be extended. Hafner points out that during a hearing before the Justice Commission of the US-Senate in 1982 in relation to possible anti-money laundering measures, a senior official of the General Prosecution Office claimed that hundreds of millions in untaxed money was available and that with an appropriate confiscation law, the state budget could easily be filled in (Hafner quotes Fried, 1988; see also Alldridge, 2008).

Apparently the US Bank Secrecy Act (BSA) of 1970, designed to detect crime-money flows, including those from tax violations, was not particularly effective, whether it concerned tax evasion or laundering. In 1993, a senior official of the US Department of Justice admitted to a congressional committee:

"*The Bank Secrecy Act was not enough, standing alone, to combat money laundering. Rather, it was necessary to make the handling of dirty money a crime in itself*" (Hoekje *et al.*, 1993, p. 3).

During a 1993 public hearing on money laundering in the State of New Jersey, Mary Medina, Chief of the Examination Division for the Internal Revenue Service in Newark, made the following statement:

"*[T]he IRS views money laundering very broadly. Any activity or practice used to conceal or disguise the existence and origin of profits or money generated, whether from legal sources or illegal sources, is a money laundering concern for us*" (Hoekje *et al.*, 1993, p. 7).

Such a statement coming from an official of the IRS clearly indicates that targeting money laundering serves the IRS well. It appears that in the early 1990s the implicit targeting of tax evasion by the BSA and anti-money laundering measures was more clearly out into the open. It became also obvious that the money laundering definition had been broadened in order to target tax evaders, even though tax evaders and tax fraudsters do not always necessarily need to undertake laundering in the strict sense of the term. The US authorities needed a tool to gather intelligence outside the USA to ensure that US citizens were not hiding their wealth overseas. As Pieth (1998) points out, it can be argued that anti-money laundering efforts have been partly aimed at ensuring global financial control (see also Alldridge, 2008). Indeed, it appears that the efforts of the US authorities to clampdown on tax evasion are far-reaching and their attacks against Swiss bank UBS demonstrate that.[65]

It should come as no surprise, of course, if the ultimate objective of US authorities has been primarily to ensure optimal amounts of state revenues. This is a priority for every government. In this context, the allegations of the CIA's complicity in drug trafficking should come as no surprise either. If the CIA wanted to keep the funding of its secret operations out of sight of the US Congress, then the CIA could not have used tax money but slush funds accumulated through other means. For instance, there are strong reasons to believe that the CIA has funded secret wars of the Contras against communist movements

65 Following an aggressive tax-evasion investigation, in August 2009, in a groundbreaking settlement the Swiss authorities agreed that UBS should reveal the names of 4.450 wealthy US citizens holding offshore accounts at UBS. Douglas Shulman, commissioner of the Internal Revenue Service, was quoted commenting: "*The IRS will vigorously pursue tax cheats around the world, no matter how remote or secret the location.*" The matter was widely covered by the press (see, for instance, Simonian *et al.*, *Financial Times*, 19 August 2009).

(including the Contra war in Nicaragua[66]) partly through complicity in, or at least the condoning of, drug or arms sales (Scott, 1992; Levi, 2002; Van Duyne and Levi, 2005). Historian Alfred McCoy (1972) believes that the CIA has been complicit in the activities of foreign drug dealers and has benefited from prohibition policies. As obvious as it may be, prohibition limits the supply of illegal drugs thus contributing to an increase in prices, which makes drug trade more profitable (Laniel, 1999). Prohibition policies have thus provided the CIA with ample opportunities for higher revenues for its alleged off-the-record budget, than it maintained officially, to finance illegal covert operations. Naturally, the CIA has denied these allegations (mentioned by McCoy, 1972).

In any event, the massive flows of monies into the Bahamas and other tax havens and the zest of US tax authorities to prosecute the likes of Lansky are difficult to disregard. Indeed, the US administration has had a number of varying political aims, some of which evidently conflicting, served by different agencies. While the Inland Revenue Service had to investigate the rush for offshore services, the CIA needed money for covert operations such as fighting left-wing movements, and the DEA had to chase drug dealers and their ill-gotten profits. As Van Duyne and Levi (2005, p. 39) observe, "*where foreign policy and the 'War on Drugs' collide, the CIA largely prevails over the DEA.*"

The question is how all this comes together and whether, while zealously pursuing anti-drug and anti-laundering policies, the US authorities have not exhibited some degree of political hypocrisy. It appears more plausible that the war on money laundering was driven by the implicit but overwhelming need to ensure higher tax revenues transcending the equally serious desire to reduce drug consumption. It goes without saying that in seeking national and international support, furthering and getting the anti-laundering policy globally accepted, the drug problem could serve as an undisputed banner.

In any case, the end result is that the US approach to fight drugs through hitting drug dealers in their pockets, was adopted internationally. By insisting that other nations should adopt anti-drug and anti-laundering regulations similar to US, the US government has effectively launched a process of Americanisation of international law enforcement and its sacred war against 'the evil' (Nadelmann, 1993; Hafner, 2002; Van Duyne and Levi, 2005) but not with-

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66 See media reports (Parry, *The Associated Press*, 16 April 1986; Pincus, *The Washington Post*, 17 March 1998). The CIA has been also alleged of complicity in opium smuggling by anti-communist Hmong hill tribesmen to fund the "*secret war*" in Laos (McMurtry, *Kitchener-Waterloo Record*, 15 August 1991; Cropley, *Reuters News*, 7 March 2006). See also studies by Chambliss, 1994, and Scott and Marshall, 1998.

out, at the very least, the tacit consent of some industrialised countries (Pieth, 1999; Boekhout van Solinge, 2002; Van Duyne and Levi, 2005). At this point globalisation coincided with a process of voluntary penal law Americanisation.[67]

3.1.6. International developments

The Vienna Convention and the Basle Statement of Principles

Two years after the introduction of the US Money Laundering Control Act of 1986, on the eve of global economic liberalisation and just before the fall of the Berlin Wall, the international community reached agreement on two documents and these represented the first major steps towards the international co-operation in the fight against money laundering. The two agreements in question were the UN Convention Against Illicit Trafficking in Narcotic Drugs and Psychotropic Substances ("Vienna Convention"/19 December 1988) and the Basle Statement of Principles on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering ("Basle Statement"/12 December 1988).

The Basle Statement outlined several basic principles with regard to the banking system, including the need for customer identification and record keeping as well as cooperation with law enforcement authorities. The Vienna Convention addressed the confiscation of assets and the issue of bank secrecy, and envisaged, *inter alia*, mutual legal assistance between Member States.

While the Vienna Convention refers only to proceeds of illegal drug trafficking, the Basle Statement of Principles does not specify the predicate crimes. However, the latter is not a legal document but only a statement that outlines generally recommended practices aimed at preventing the use of the banking system for the purpose of money laundering. The Vienna Convention, however, does not merely recommend but requires its signatory states to undertake a set of specific measures, among which the criminalisation of laundering of proceeds derived from illicit drug trafficking.[68] Prior to this Convention international anti-money laundering initiatives had always resulted merely in general recommendations and conclusions. One of the earliest documents of this kind is the report of the Committee of Ministers of the Council of Europe of June

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67 As we shall see in the next sections, the wording of the internationally adopted laundering definition was effectively copied from the US 1986 law.

68 Notably the Vienna Convention states that each Party may consider ensuring that the onus of proof be reversed regarding the lawful origin of alleged proceeds or other property liable to confiscation, to the extent that such action is consistent with the principles of its domestic law and with the nature of the judicial and other proceedings.

1980, which states that the banking system can play a highly effective preventive role and that the cooperation of the banks can assist in the repression of criminal acts by the judicial authorities and the police. [69]

By adopting the Vienna Convention, policy makers recognised the need to address money laundering at an international level. However, this attention was still restricted to the context of illicit drug trade, which was a consequence of the awareness campaign launched in the USA.[70] As we have seen earlier in this thesis, legislative developments in the USA spurred international developments in the fight against money laundering. The Vienna Convention and the Basle Statement of Principles were largely based on concepts developed in the USA. In turn the Vienna Convention and the Basle Statement of Principles laid down the foundation for further international legislative developments, fostered by globalisation. The worldwide spread of US standards in the area of law enforcement, specifically anti-money laundering policy making, became an increasingly pronounced trend. Since the late 1980s we have seen how local contexts have been reshaped to adapt to the unfolding global order. Internationally shared concepts have been translated into endorsed legal definitions and assumptions, which have influenced the development of national legal standards.

The 40 Recommendations of the FATF as an instrument for global pressure

The process of spreading standards in policy making takes place either indirectly, on the basis of general recommendations or, in the case of treaties, directly and explicitly, on the basis of harmonisation requirements to signatory states. Some changes may be required, others remain optional. However, in the field of money laundering control, the Financial Action Task Force on Money Laundering (FATF), an informal *ad hoc* structure formed by the G7 in 1989,[71]

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69 Recommendation No.R(80)10 adopted by the Committee of Ministers of the Council of Europe on 27 June 1980 entitled 'Measures against the transfer and safeguarding of the funds of criminal origin' (see for comments Stessens, 2000). This appears to have been largely driven by the introduction of the BSA and related regulations in the USA during the 1970s.

70 The US Money Laundering Control Act of 1986 refers to proceeds from "specified unlawful activity" which, in addition to drug proceeds also includes, *inter alia*, the proceeds of theft, embezzlement, bribery and other crimes. Nevertheless, for a number of years the focus remained largely on drug-related offences. As previously mentioned, the Act was signed into law as part of the Anti-Drug Abuse Act of 1986.

71 The FATF was established in July 1989 in Paris during the 15th annual Economic Summit of the G7: USA, Japan, Germany, France, UK, Italy, Canada. The Summit participants also invited Sweden, the Netherlands, Belgium, Luxembourg, Switzerland, Austria, Spain and Australia to join the Task Force. Since then the list of Member Countries of the FATF has expanded (see Kremer, 2004, for a detailed account of FATF's history and activities). Additionally, a number of

has set an unusual precedent. As Pieth (1999) points out, the FATF introduced a new methodology into international law: recommendations that proved to be no less imperative than treaty obligations. As the Vienna Convention alone was not sufficient to establish a global anti-money laundering regime, the FATF stepped in to speed up the process. The USA needed an international forum to promote or, if necessary, to impose policies worldwide and the FATF became this forum. It was created to help enhance international cooperation and assess the results of anti-money laundering policies globally.

In 1990, the FATF issued a report, which laid down 40 anti-money laundering recommendations.[72] The report described the purported state of affairs concerning drugs money and claimed that crime-proceeds annual estimates reached $300 billion. Although this claim appears to be based on evidence of highly questionable validity (see Van Duyne, 1994), it proved to be a token of clever rhetoric which strengthened FATF's case in imposing global control policies and justified its recommendations. But even this was not sufficient. The FATF had to ensure that these recommendations would be implemented. So the FATF introduced procedures of peer review and multilateral monitoring of the implementation processes in order to assess the extent to which countries have complied with the recommendations. With its procedures of country evaluations the FATF effectively turned its recommendations into an instrument of social and political pressure (see Pieth, 1999; Stessens, 2001; Levi, 2003; Van Duyne and Levi, 2005).[73] Stessens (2000, p. 18) denotes FATF's recommendations as a "*non-binding soft law*" and points out that the choice of recommendations over treaty, as an instrument to enforce certain standards, was deliberate, as it made it possible to avoid the complex ratification procedures, by-passing democratic structures. However, the end result was not a 'soft' in-

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FATF-style regional organisations have been established to promote and enforce the FATF recommendations (Asia / Pacific Group on Money Laundering (APG), Caribbean Financial Action Task Force (CFATF), Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) (formerly PC-R-EV), Eurasian Group (EAG), Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), Financial Action Task Force on Money Laundering in South America (GAFISUD), Middle East and North Africa Financial Action Task Force (MENAFATF)).

72 The FATF revised its recommendations in 1996 and in 2003, and additionally issued nine special recommendations on terrorist financing (eight in 2001, and one in 2004) as well as various Interpretative Notes to reflect developments in money laundering practices and to provide further guidance.

73 The FATF website (Monitoring the Implementation of the Forty Recommendations) states: "*The mutual evaluation process is enhanced by the FATF's policy for dealing with members not in compliance with the Forty Recommendations. The measures contained in this policy represent a graduated approach aimed at reinforcing peer pressure on member governments to take action to tighten their anti-money laundering systems*".

formal approach, but a process of imposing politically binding standards on the evaluated countries.

In 1998, when it was recognised that many countries still lacked an adequate anti-money laundering regime, the FATF launched the Non-Cooperative Countries and Territories (NCCT) Initiative. Unless evaluated countries (and territories) complied with FATF's standards they risked to be branded and blacklisted as 'non-cooperative', and consequently to be rejected as partners in the international payment system with serious potential consequences for their economy (see Stessens, 2000). The FATF's aim was that evaluated countries feared the potential reputational damage which would urge them to address the deficiencies identified by the FATF (see FATF Eight NCCT Review, 2007). The adopted approach ensured a one-sided verdict with virtually no possibility for appeal but with the only alternative: to comply. Thus the "*name and shame initiative*" proved to be quite a success (Kremer, 2004, p. 23).

Yet the FATF came under mounting criticism from the academic world (see Pieth, 1999; Stessens, 2001; Levi, 2003; Williams and Baudin-O'Hayon, 2002; Kremer, 2004; Van Duyne and Levi, 2005). Taking the role of an auditor with no mechanisms for shared accountability for its work the FATF risked being accused of applying double standards, exhibiting an approach that cannot but be described as authoritarian. While listing some countries as 'non-cooperative' for certain deficiencies, the FATF seems to be overlooking, or looking upon with a lesser degree of criticism, similar deficiencies in the regimes of other countries. For instance, FATF's acceptance of Luxembourg's endowment outside the normal funding system was interpreted by some bloggers as a sign of willingness to turn a blind eye, or at the very least, be less critical, to possible deficiencies in the anti-money laundering control system in that country. In its 2006-07 Annual Report (of 29 June 2007) the FATF not only diligently listed its expenditures and explained its regular funding scheme but also expressed gratitude to Luxembourg for "*a generous grant*" (FATF, 2007, p. 12) that helped the FATF improve its information technology systems. This provoked blog comments including: "*Luxembourg and the FATF: Profoundly unethical conduct*"[74] and "*the 'generous gift' received by the FATF from Luxembourg is a threat for the financial community worldwide […]. The affair is worrying.*"[75] Although criticism does not appear to have extended beyond these references

[74] Murphy, posted on 22 December 2007.

[75] Turquey, posted on 25 December 2007.

(and the FATF apparently did not condescend to address this criticism, which risked it being viewed as exhibiting an undemocratic attitude), these instances certainly indicate that the FATF is not immune from public scrutiny, albeit ineffective.

On its website the FATF has highlighted that the NCCT Initiative was aimed at ensuring the implementation of "*internationally recognised standards*".[76] Yet these standards were primarily created by the G7, with the USA taking the lead. Therefore, after twenty years of rigorous anti-money laundering campaigning by the US authorities, one would expect the USA to have by now put in place a nation-wide dirty-money resistant system. Whether this is the case, remains a question. It is interesting to note, however, that in its 2006 review of the anti-money laundering regime in the various states of the USA, the FATF mentioned that corporation laws and reporting requirements in Delaware and Nevada "*are such that the information on beneficial ownership may not, in most instances, be adequate, accurate or available on a timely basis*" (FATF, 2006, p. 9). The FATF further noted that this is "*a vulnerability*" for the anti-money laundering regime in the USA (FATF, 2006, p. 9), a quite benevolent conclusion compared to the measures that the FATF has meted out towards other countries, some of whose defects were arguably even smaller.

Indeed, over the years the FATF seems to have generally softened its approach and as of 2007 no countries were listed as 'non-cooperative'. But that does not mean that money laundering is no longer taking place or that the degree of 'vulnerability' in Delaware is lower or higher than in other states and countries, irrespective of whether they are wealth or tax heavens. Whether information on beneficial ownership should be easily available and be a matter of public record for the sake of transparency *per se* is a debatable matter the approach to which continues to vary from jurisdiction to jurisdiction. We should not forget, however, that even in countries with the most transparent business environment it may be difficult to penetrate beneath the corporate veil of a business to identify the ultimate beneficial owner. It may be sometimes practically impossible to understand whether a registered shareholder is a nominee figure or indeed a beneficial owner. Therefore, rigid requirements for disclosure of ownership alone may not necessarily guarantee transparency and prevent money laundering. It is important to ensure that requirements are realistic and take into account the differences in the various economic, political and social conditions, culture and legal traditions across countries. In some countries

76 FATF website: About the Non-Cooperative Countries and Territories (NCCT) Initiative.

reporting institutions readily disclose their records to the authorities if required, but these records may be poor; in others, disclosure can take place only after lengthy procedures of issuing court orders but the degree of detail of the disclosed information may prove to be reasonably high. The FATF has sought to achieve some level of consistency in the anti-money laundering approach across the world as money laundering is a 'global' phenomenon. While some level of consistency in disclosing ownership to the public may indeed be helpful, it remains a question how consistent has been FATF's effort in naming and shaming the countries it evaluates.

Further legislative developments

The 40 Recommendations of the FATF, as it appears, were prepared "*within less than half a year, with no ulterior ambition and very little academic preparation*" (Pieth, 1999, p. 531). However, they served their purpose: to create tools for global financial control and lay the foundations for further international legislative developments along the US lines. According to a 1996 report of the US General Accounting Office,[77] "*the United States' multilateral efforts to establish global anti-money-laundering policies occur mainly through FATF*" (p. 8). The FATF also became instrumental in the efforts of the US to broadcast the "*threat image*" of organised crime (see Van Duyne, 2004, pp. 22-34). The FATF has directed the war on financial crime and money laundering by acting as an informal vehicle for enforcing US foreign policy in this field. The push for further international policy making based on the FATF recommendations led to the introduction of several legislative anti-money laundering documents including:

- The 1990 Council of Europe Convention No 141 on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (the Convention, which became known as the Strasbourg Convention, was adopted in September 1990, opened for signing on 8 November the same year, and entered into force on 9 January 1993);
- Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism Warsaw (opened for signing on 16 May 2005 and signed by the European Union on 2 April 2009);[78]

77 Renamed in 2004 Government Accountability Office.

78 Essentially the Warsaw Convention adds the anti-terrorist financing element to the Strasbourg Convention. It also specifically states that each Party shall ensure that a prior or simultaneous conviction for the predicate offence is not a prerequisite for a conviction for money laundering; and each Party shall ensure that a conviction for money laundering is possible where it is proved

- Council Directive of the European Communities of 10 June 1991 on Prevention of the Use of the Financial System for the Purpose of Money Laundering (91/308/EEC) (also referred to in this thesis as the 'First (EU) Directive');
- Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on Prevention of the Use of the Financial System for the Purpose of Money Laundering (also referred to in this thesis as the 'Second (EU) Directive');
- Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing (this Directive repeals Directive 91/308/EEC and Directive 2001/97/EC) (also referred to in this thesis as the 'Third (EU) Directive');
- UNDCP Model Law of 1995 on Money Laundering and Confiscation in Relation to Drugs and the model texts of the Organisation of American States.

These documents were no longer centred on drug trafficking. The 1990 Council of Europe Convention expanded the definition of money laundering beyond that laid down by the 1988 UN Convention, which defined laundering in association with drug-related offences only. The Council of Europe Convention describes as a "predicate offence" the underlying criminal activity that generates the proceeds[79] subject to subsequent laundering (see Gilmore, 1993, for a further account of international legislative developments). Now the list of predicate crimes includes practically all types of economic crimes (with some exceptions in various countries).

The global network of FIUs in an extended conceptual framework

An important element of the global anti-money laundering regime has become the system of reporting suspicious or unusual activities to designated authorities, or, as they became known, Financial Intelligence Units (FIUs).[80]

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that the property, the object of paragraph 1.a or b of article 9 (see Addendum 2), originated from a predicate offence, without it being necessary to establish precisely which offence.

79 As reviewed later in this thesis, the Convention defines 'proceeds' as: any economic advantage, derived from or obtained, directly or indirectly, from criminal offences. It may consist of any property as defined in sub paragraph b of this article.

80 In 1996 the Egmont Group (the establishment of Egmont Group is discussed later in this section) adopted a definition of FIU that was later incorporated in the revised FATF recommendations of 2003 and other international documents. Egmont Group defined FIU as: a central, national agency responsible for receiving (and, if permitted, requesting), analysing and disseminat-

As reviewed earlier, the USA has been a major driving force behind the establishment of the existing global anti-money laundering control system with its integral network of FIUs worldwide. Through the FATF the US imposed a strategy that required financial and other businesses to start reporting any suspicious or unusual activities to "the competent authorities", *i.e.* the FIUs. This was mainly the result of a distinctive drive for financial intelligence (intelligence concerning, in the main, financial transactions and money flows) and the need to streamline efforts in the process of intelligence gathering and processing. The US agency which was tasked to further this development, FinCEN, will be mentioned again later.

In some places, primarily world financial centres, appropriate units were set up in the mid-to-late 1980s, at around the time of the introduction of the Vienna Convention and the Basle Statement of Principles as well as relevant national anti-drug trafficking legislation. For instance, the UK established the National Drugs Intelligence Unit (NDIU) in 1985. The NDIU[81] was assigned with the task of collecting disclosures concerning drug-related suspicious transactions from financial institutions and providing relevant intelligence to other investigative agencies (see Price, 1992). The Isle of Man Financial Crime Unit became operational in 1986, while the Cayman Islands' Financial Reporting Authority (CAYFIN), and Hong Kong's Joint Financial Intelligence Unit (JFIU), both became operational in 1989. Guernsey's FIU, the Financial Intelligence Service, was formed in 1989. Australia founded its own FIU, the Australian Transaction Reports and Analysis Centre (AUSTRAC), in 1989 in accordance with the Financial Transaction Reports Act of 1988, and the unit began operating in January 1990. The American FIU, the Financial Crimes Enforcement Network (FinCEN), was established in April 1990[82] (see Gelemerova, 2008).[83] Clearly in many jurisdictions the authorities had already taken

ing to the competent authorities, disclosures of financial information: (i) concerning suspected proceeds of crime, or (ii) required by national legislation or regulation, in order to counter money laundering (Egmont Group, 2003, p. 2). This definition was later expanded further to include terrorist financing.

81 For many years the UK's FIU was the National Criminal Intelligence Service (NCIS), which was formed out of the NDIU and set up as a separate body in 1992. In 2006 NCIS was merged into a newly created agency, Serious Organised Crime Agency (SOCA).

82 In October 1994 FinCEN was merged with the Treasury Department's Office of Financial Enforcement (OFE) which had previously administered the BSA (see posting by Pike on the website of FAS, 1998).

83 The history of FIUs and the strategy of expanding the intelligence drive internationally was examined in detail in "On the frontline against money-laundering: the regulatory minefield" (Gelemerova, 2008). I am grateful to the Egmont Group Secretariat for assisting me in confirming these dates.

anti-laundering measures or, otherwise said, the minds were already ripe for establishing such a regime before the FATF started its work. One may wonder why the 1990 FATF report was so necessarily alarmist, but once the G-7 endorsed the new policy, FinCEN assumed the lead role in expanding the intelligence drive internationally.

However, despite these early developments, the role of FIUs as central units for gathering intelligence on potential money laundering was yet to be enforced and strengthened during the 1990s. The 1990 Council of Europe Convention and the 1991 EU Council Directive (91/308/EEC) urged member states to assign authorities specifically responsible for combating money laundering. However, it was not until the mid-1990s that FIUs were recognised on a larger scale as a central component of the global anti-money laundering strategy.[84] This was achieved largely through the establishment of Egmont Group. It was founded as an informal organisation by several FIUs, including FinCEN, on 9 June 1995 in Brussels. The establishment of the Egmont Group strengthened international cooperation as it helped improve the cross-border exchange of information.[85] This role of Egmont Group and the process of intelligence gathering and sharing on a global scale have been fostered by FinCEN in particular. FinCEN states[86] that since 1995 "*the U.S. has pursued an aggressive policy of promoting a worldwide network of financial intelligence units in its overall strategy of fighting money laundering and terrorist financing*." By sharing information that may help identify criminals and money launderers (some of whom are one and the same person) FIUs help fight money laundering on a global scale. However, apart from the obvious human rights and data protection limitations relating to such procedures, FIUs had at some point to address problems of cooperation resulting from the differing legal statuses of different types of FIUs. The Egmont Group (2003) defines the following types of FIUs:

(i) the judicial type (or prosecutorial, as defined by the IMF (2004)) exists within the judicial branch of the state;
(ii) the law enforcement type exists within the national law enforcement system;

84 During the early 1990s the establishment of FIUs was still viewed as "*isolated phenomena related to the specific needs of those jurisdictions establishing them*" (see Egmont Group, 2003, p. 3).

85 The Egmont Group designed a memorandum of understanding (MOU) to help FIUs overcome problems relating to information sharing. The MOU is a set of principles for information exchange based on reciprocity and only for the purposes of analysis at FIU level, with no further use allowed without the prior consent of the FIU that provided the information.

86 See report by US Department of the Treasury and FinCEN (2006, Appendix A, p. 41).

(iii) the administrative type is "*a centralized, independent, administrative authority, which receives and processes information from the financial sector and transmits disclosures to judicial or law enforcement authorities for prosecution. It functions as a 'buffer' between the financial and the law enforcement communities*" (Egmont Group, 2003, p. 3);

(iv) the hybrid type combines elements of at least two FIU models (of those named above) and functions as an intelligence processing and disseminating body for the police and judicial authorities.[87]

According to a report by the European Commission (1998), at some points FIUs of law enforcement type in certain Member States were only able to cooperate with similarly placed law enforcement counterparts. The report states that with regards to cooperation "*[t]he main obstacle has been found to be the different nature of the FIUs in different countries*" (p. 14). Gradually, however, as a result of further legislative developments, particularly following the terrorist attacks of 11 September 2001, an increasing number of countries have introduced measures that allow their respective FIUs to share information with other FIUs, even if they are of a different type (IMF, 2004).[88]

Over the years changes in the strategy for the war against money laundering have resulted in the constant expansion of the outreach of anti-money laundering measures. As was observed earlier, originally money laundering was associated primarily with illicit drug trade but, gradually, the list of predicate crimes came to include practically all types of crimes-for-profit[89] (with some exceptions in various countries).

Additionally, the group of entities obliged to report suspicious transactions significantly expanded over the years to include not just classical financial service institutions, but also casinos, brokerage and securities firms, lawyers, notaries, auditors, real estate agents and so on.[90]

87 See for more details on the effects of these types, Gelemerova, 2008.

88 In some instances problems relating to information sharing have been overcome through Egmont Group's MOUs, mentioned previously.

89 The Strasbourg Convention (1990) expanded the definition of money laundering beyond that laid down by the 1988 UN Convention, which defined laundering in association with drug-related offences only. The Strasbourg Convention describes the underlying criminal activity that generates the money subject to subsequent laundering as a "predicate offence" (see Gilmore, 1993, for an account of international legislative developments). The European Commission's report of 1998 (p. 8) notes with regard to the First EU Directive (91/308/EEC): "*The Directive only requires the prohibition of the laundering of drugs proceeds, as required by the Vienna Convention, but encourages Member States to apply the approach of the Strasbourg Convention, namely of combating the laundering of the proceeds of a wider range of criminal offences (often referred to as "predicate offences").*"

90 Following the Money Laundering Control Act of 1986, the US government introduced a number of additional federal statutes and regulations that significantly expanded the list of re-

Furthermore, after the events of 11 September 2001 the criteria for reporting suspicious transactions expanded to include also transactions that may be related to terrorist funding. The Third EU Directive places a particular emphasis on this issue. This means that reporting entities now have to watch out not just for potentially dirty money but also clean money that may serve terrorists.

All these changes have resulted in extending the outreach of the anti-money laundering regime. The effect of this outreach has been underpinned by the broad definition of money laundering. The concept of money laundering has been broadened to include virtually every consequential act of any crime for profit (Stessens, 2000; Van Duyne *et al.*, 2005), as we will see in the next chapter.

3.2. Definition analysis

Numerous official reports and research papers have been written about money laundering but views about the phenomenon continue to vary broadly. This chapter will review some more common and some less traditional interpretations of the money laundering definition.

3.2.1. Requirements for a definition

Every phenomenon that is being observed for the first time attracts the attention of researchers who try to explore it and understand its nature. Sometimes they attempt to coin a word for that phenomenon, but very often there is already an existing word, which is adopted to denote the observed phenomenon. This word becomes a common term. While the meaning of certain terms is not strictly delineated, others have definite boundaries that leave little or no room for interpretation. Terms with clear meaning and measurable contents are easy to apply. It is important to use such clear terms with measurable contents in socio-political and economic contexts where specific phenomena may affect the organisation of the whole society. Often such phenomena represent urgent matters of an immediate and evident societal effect. When that is the case, we may regard such phenomena as social 'problems'. However, not all social prob-

porting institutions and ensured that certain groups of organisations outside the banking system were also subject to formal reporting requirements. For instance, the Money Laundering Suppression Act of 1994 imposed more rigid reporting requirements on non-banking financial institutions (*e.g.* brokerage companies and some tribal casinos), which prior to that point had been largely unregulated. Gradually, the US approach to extend the list of reporting institutions was adopted globally.

lems are clear and neatly delineated. But, if such a problem has to be tackled, particularly by the authorities, it has to be defined. Not only because the administration (and the citizenry) has to be aware of its precise nature (often difficult enough), but also because addressing the problem can have an impact on the society as a whole. For example, while increasing the pay of just one teacher does not affect the society, increasing the pay of all teachers in order to pre-empt an announced strike may have irreversible consequences (*e.g.* a wave of pay-rises, inflation and so on) for the whole nation.

In order to address a specific problem it is critical to measure it, especially if this problem is the subject of policy making. If we are to use a modern 'buzz word', policy making needs to be 'evidence-based', *i.e.* based on sufficient and reliable data to ensure that decisions are adequate and do not deviate from reality. Otherwise, the collateral damage from the problem solving may be more harmful than the problem itself. For example, policy makers may resort to far reaching measures because of an insufficiently specified fear, as is the case with organised crime, or, as some authors describe it with regard to EU organised crime policy making, end up with 'ritual incantations' (Van Duyne and Vander Beken, 2009). What does this evidence-based policy making look like in the field of crime-money?

For many years researchers and policy makers have sought to assess the social and economic consequences of crime and crime-money. While certain crimes, such as theft, have had an unambiguous meaning since the times of King Hammurabi, other forms of delinquency have puzzled researchers and (sometimes) policy makers alike because of their blurring contents. This has applied particularly to categories of criminal conduct, which have been constructed out of a range of or cover a range of other forms of unwanted conduct. The meaning of terms such as 'organised crime', 'serious crime' or 'transnational crime' have been the subject of an ongoing debate. Definitions of these phenomena vary from colourfully 'impressionistic' and 'expressionistic' to purely 'black-and-white', and none of these necessarily reflects the reality: bits of it are depicted, albeit through 'frosted glass' (see Van Duyne and van Dijck, 2007b). With a few exceptions, these definitions hardly meet the requirement for an empirical definition: to unambiguously determine the outline of observable behaviour that is being described by means of its distinct features, while excluding all other, irrelevant types of behaviour.

Apart from the possible defective wording, the problem with these terms may also be that they do not only intend to denote identifiable phenomena (if, at all, these phenomena can be identified), but the application of their definition depends on other processes and conditions of observation. These processes and conditions in turn also have to be adequately defined, and possibly made measurable: this is the process of operationlisation of a concept. If there are defects on this point, one may end up with a compilation of, and interaction between, fuzzy concepts and procedures. For example, transnational (organised) crime is supposed to develop in the context of the equally not very clear phenomenon of globalisation. Transnational crime and organised crime themselves are predicate to money laundering, an equally ambiguous term. Money laundering in turn is arguably facilitated by globalisation. These are all ill-defined (or difficult to define, as is the case with 'globalisation') terms with an interconnected application, accumulating distortions implied in each of them. The interaction between the underlying phenomena can hardly be observed, let alone measured. But while measuring globalisation may not be viewed as an urgent necessity for the organisation of the society, measuring phenomena such as organised crime and money laundering are considered a serious undertaking. This is because they are supposed to have a direct impact on the fabric of society and the establishment and maintenance of law, order and justice.

Since recently Eurostat, the EU statistics bureau, has started developing methods of measuring 'organised crime' and collecting relevant statistics. Thus far this undertaking appears to be failing: without a proper operational definition 'counting' organised crime is like 'counting clouds' (see Van Duyne, 2006; Verhage, 2008). Given the unsatisfactory outcome of the annual situation reports, the High Level Group of the EU invited Europol to design an annual Organised Crime Threat Assessment (OCTA). According to some authors (see Van Duyne, 2007; see also Van Duyne and van Dijck 2007b; Van Duyne and Vander Beken, 2009) this failed too due to a fuzzy (but secret) methodology and defective definition. Therefore the question remains whether an adequate method and coherent definition can be found which can be applied across the EU, and possibly further afield.[91]

In general one can say that definitions containing immeasurable components, *e.g.* value elements such as 'seriousness', do not qualify as definitions because of the arbitrariness of interpretation. For instance, how serious is the crime committed by an organised group of shoplifters or pickpockets causing unrest in the city centre and among stores personnel? In terms of scope and timespan it may prove to be more serious than other crimes against property.

91 The EU-supported project *Assessing Organised Crime* designed an empirical 'bottom-up' procedure for assessing organised crime. For a more elaborate description see the website of Cross-Border Crime Colloquium: www.cross-border-crime.net.

According to criminologist Paul Cromwell *et al.*, shoplifting has significant economic implications for consumers (Cromwell *et al.*, 1999). Yet shoplifting and pocket-picking are generally perceived as minor offences. General perceptions, however, cannot be translated into penal law without precise considerations. Arbitrary interpretations and lack of clarity mean that the application of terms may have uncertain consequences which within the rule of law can be at odds with the principle of *lex certis*. Therefore, concepts such as 'organised crime' should have a clear empirical definition to be applied as a decision rule. This decision rule is to determine the observables that are to be included in the set of counting units subject to examination (Van Duyne and van Dijck, 2007b).

The phenomenon of money laundering appears also difficult to assess as it depends on other crimes. It is a consequential crime that only exists in the context of another, predicate crime. However, the phenomenon in its strictest sense is not difficult to understand and define. It is the range of its broader definitions that complicates the situation and makes it difficult to research the 'phenomenon' of money laundering. In order to address the 'phenomenon' of money laundering and measure it, we first need to have a working empirical definition as a basis. Researchers at the Utrecht School of Economics have identified 18 existing definitions of money laundering (Unger *et al.*, 2006). The majority of existing definitions, however, do not necessarily reflect the *essence* of the laundering phenomenon. Instead they mirror the broad definition introduced by the USA, as it will be reviewed in the next chapters.

3.2.2. The essence of money laundering

(Money) laundering – in the strict meaning of the word – is aimed at a clear final result: the achievement of a misleading appearance of 'cleanness', or legitimacy, whether it concerns illegally acquired money or illegally acquired property such as stolen valuable objects. In other words, laundering takes place where "*someone constructs a pretended false legitimate origin of money or other illicit property. All other actions of concealment remain what they are: concealment as long as they are not followed by that very step of false legitimation*" (Van Duyne and De Miranda, 1999, p. 262).

For example: stolen objects of art must be laundered by forging a document of origin; stolen cars are laundered by tampering with the chassis and engine numbers, as well as with the registration details. The English term appears to be self-explanatory. Its semantic kernel of 'whitening' and 'cleansing' is also properly expressed in the German, Dutch and French words: Geldwäscherei (or Geldwäsche), witwassen or blanchiment. Despite this apparent semantic clarity of the term, definitions of 'money laundering' vary widely and in many cases extend beyond their semantic meaning. The expression usually conjures images of complex financial operations undertaken in several jurisdictions, most likely offshore as well. Robinson (1994) defines 'money laundering' as a series of transactions at the end of which the illicit or 'dirty' money re-emerges as licit or 'clean'. Aninat *et al.* (2002), representatives of the IMF, note:

> "*Money laundering involves transforming the proceeds of crime into usable form and disguising their illegal origins. After the criminal proceeds are introduced to the financial system, they are hidden – laundered – through a variety of transactions and financial vehicles and finally invested in financial and related assets. These operations often involve international transactions as a means of 'layering' – that is, of obscuring the source of the funds.*"[92]

This description contains repetitions and ambiguities and even, to an extent, inaccuracies. Typically criminal proceeds are not hidden after they have been introduced into the financial system but, by their very nature, they are hidden from the start. It is also not necessary to perform a variety of financial transactions: a fictitious loan or a forged inheritance document may suffice to provide the appearance of legitimate origin (especially given that due diligence checks are not always adequate or are altogether lacking). Running a casino could also be a way to launder. Hence, money laundering does not need to be as sophisticated and achieved through international operations but can entirely be carried out domestically. What is important to crime-entrepreneurs is to purge the crime money of its criminal smell (needless to say that Vespasian's observation is apparently no longer valid) in order to enjoy the fruits of their undertakings. Spending crime-money can create evidence against the spender. For instance, spending on registered goods, like cars, houses and boats, creates direct evidence. Spending on other objects can also leave traces that allow investigators to conduct a net-worth analysis (Albanese, 1996; Abadinsky, 2002). In order to prevent this from happening criminals have to put certain mechanisms in place, for instance:

- to place the assets in the name of a straw man or an offshore vehicle;
- or to seek to spend their money in an undetectable manner by avoiding the issue of invoices and the consumption of services, such as air travel, that have to be documented;

92 Third paragraph (no page number available as the material was derived from online sources).

- additionally, criminals may resort to forgery, facts misrepresentation, documentary fraud and so on.

Policy makers define all these manoeuvres as 'disguising' the crime assets. Along these lines FinCEN has provided the following definition on its website:

> "*Money laundering involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Through money laundering, the criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source.*"[93]

Indeed disguising is not good enough if it does not achieve the ultimate goal of money laundering: the apparently legitimate origin of the crime assets. Even if one takes his funds through a series of transactions, obscures the source of funds and avoids leaving traces when spending money, any visible increase in wealth that exceeds the declared income will normally have to be accounted for retrospectively. This means that even if such measures, as the above mentioned, are taken, the laundering remains imperfect if justification for this increase in wealth has not been ensured. Therefore, definitions which suggest that blurring the paper trail suffices to make the criminal proceeds usable and untouchable, to an extent deviate from reality.[94]

> Had the late Jose Gonzalez Rodriguez-Gacha, one of the most notorious leaders of the Medellin cartel, ensured that his funds had not only been well hidden but had been justified, his family would most likely have retained some part of his personal income and properties worth many millions of dollars. The money went through a series of transfers to various accounts in the USA, Luxembourg, Switzerland, Austria and the UK, but was eventually tracked down and frozen by the US Department of Justice in 2001.[95]
>
> Unlike Gacha, the late Konstantin Dimitrov aka Kosyo Samokovetsa, an alleged drug dealer and contraband smuggler from Bulgaria, managed to leave to his wife Angelinka substantial wealth, some of which he had justified as legitimate profits from potato production (this subject will be touched upon later in this thesis[96]).

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93 FinCEN's website (Frequently Asked Questions. What is money laundering?).

94 Although sometimes the reality may be that, due to high-level corruption, funds from obscure offshore vehicles are easily accepted, *i.e.* some blurring of the paper trail may well suffice for corrupt government officials to accept such funds without questioning the origin.

95 See report by Beaty and Hornik in *Time*, 2001.

96 See section 4.3.3. Developed versus developing economies and something in between.

Making crime-money really white is supposed to be the prime concern of crime-entrepreneurs and law enforcement alike. Nevertheless, as we will see from the next sections, the wording of the majority of existing money laundering definitions goes no further than to describe money laundering as hiding the source of the illegal wealth, although this can be expected from any sensible profit-oriented criminal. However, as reviewed in earlier sections, the money laundering theme was placed on the political agenda during a time when significant attention was paid to the *cash*-based cocaine economy. Therefore the approach was (and still is) mostly centred on the movement and concealment of crime money in the form of bags of bank notes. On the other hand, it may be the case that even affluent criminals launder much less in the sense of 'whitening' than they are supposed to. If that is the case, the integrity of the financial system is much less at risk than it is assumed to be.

3.2.3. Broadening the definition

While it is commonly understood that money laundering is ultimately aimed at presenting the funds as having an apparently legal source, legislative developments in the USA and internationally have led to the adoption of far broader definitions. It appears that the definition clarity we normally strive for may be something different to what law enforcement or a legislator is striving for. The concern of the latter is not to have a subtly worded definition with impeccable semantics but to have a penal clause that covers enforcement interests.

In 1984 the US Commission on Organized Crime defined money laundering as "*the process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate*" (President's Commission on Organized Crime,[97] 1984, quoted in Humberto Fidel Regalado Cuellar, petitioner v. United States of America, No. 06-1456, p. 17). The Commission apparently sought to create an all-inclusive definition which covers also instances of corrupt application of money that is not necessarily of illicit origin (for instance, the use of legal funds in circumvention of election laws). However, in its all-inclusiveness the definition is inherently contradictory. If one has found a way to conceal the illegal application of income, this

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97 The Commission was established by President Ronald Reagan in 1983 to investigate organised crime, including sources of income, and to assess the effectiveness of relevant federal laws (Exec. Order No. 12,435, 3 C.F.R. 214 [1983]). The Commission's report led to the initiative in Congress to criminalise money laundering (see Humberto Fidel Regalado Cuellar, petitioner v. United States of America, No. 06-1456).

would mean that one has already found a way to apply his income without being detected, hence there is no need of disguising that income.

Nevertheless, this definition is more coherent than some subsequently designed definitions. It contains the essential element of making the proceeds appear legal. Yet it laid the foundation of the later conceptualisation of money laundering (Werner, 1996; see also Stessens, 2000) in that the concept has been extended to include the mere *possessing* and *concealing* of the very existence of one's illegal income. One may wonder whether the authors of this definition realised the logic of the wording: the conjunctive '*and then*' implies that if the sentence component after the conjunctive does not occur, the whole proposition does not apply. Namely: a conjunctive only holds if and only if both components are true.

When enacting the Money Laundering Control Act of 1986, the first US federal law which criminalised money laundering, the US Congress chose to use the disjunctive 'or' instead of the conjunctive 'and' in the 'disguise provision'. Thereby the concept was broadened to the extent that it now covers the mere movement, deposit and handling of dirty money (thus making practically no differentiation between money laundering and fencing), but not necessarily the element of false justification.[98] Every type of transaction, financial or commercial, in criminally derived assets, regardless of whether it is aimed at providing legitimate appearance to the assets constitutes money laundering as long as it is not reported to the authorities. Along these lines, the Money Laundering Control Act of 1986 provides the following definition: section 1956 (a)(1) of the Act makes it unlawful to engage in a financial transaction with knowledge that the funds are the proceeds of a specified unlawful activity and

§ with the intent to promote specified unlawful activity (Sec. 1956 (a)(1)(A)(i));

§ with the intent to engage in conduct constituting a violation of certain tax laws (specifically sections 7201 or 7206 of the Internal Revenue Code) (Sec. 1956 (a)(1)(A)(ii));

§ knowing that the transaction was designed in whole or part: (i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity (Sec. 1956 (a)(1)(B)(i)); or

98 Of course, 'false justification' can be interpreted as 'handling' and thus be covered by the definition but 'the false justification element' is not made explicit and mandatory. However, it is uncertain whether the insertion of a false invoice into a firm's paperwork should count as 'handling' crime-money. For instance, with Enron's managers, charged with fraud and money laundering, we have a case of laundering by means of justifying false invoices and tampering with the books.

(ii) to avoid a state or federal reporting requirement (Sec. 1956 (a)(1)(B)(ii)). (See Addendum for full text of the section.)

Section 1956 (a)(2) makes it unlawful to transport, transmit, or transfer a monetary instrument[99] or funds into or out of the US:

§ with the intent to promote the carrying on of specified unlawful activity; or
§ where the defendant knows that the funds are the proceeds of unlawful activity and that the transportation or transfer is designed to conceal or disguise the nature, location, source, ownership, or control of the proceeds of specified unlawful activity or to avoid a transaction reporting requirement. (See Addendum for complete text of the section.)[100]

Section 1957 of the Act appears broader as it addresses all financial transactions involving any unlawfully derived property exceeding $10.000.

Essentially the Act introduced two main types of money laundering offences which became known in the US legal community as 'promotion money laundering' (to conduct a financial transaction using criminal proceeds with the intent to promote a criminal activity) and 'concealment money laundering' (to conduct a financial transaction using criminal proceeds knowing that the transaction was designed to conceal or disguise the nature, source, location, ownership or control of the proceeds).

Since the introduction of the Money Laundering Control Act of 1986, almost every newly invented definition or description of money laundering has reflected the 1986 Act, except that definitions no longer centre on financial transactions and monetary instruments but encompass any type of activity and any type of assets (and also, 'promotion money laundering,' although it has not been universally accepted across countries).

Apart from such broadening, the wording of the 'definitions' itself shows a varying degree of impreciseness. In 1993, a State New Jersey Commission of Investigation provided the following interpretation:

"*The various strategems used to conceal the money and protect the illegal sources from which it is derived are commonly called money laundering*" (Hoekje *et al.*, 1993, p. 1).

99 Which can also mean banknotes.

100 Section §1956 contains the promotion and concealment statutes. Section §1957, the spending statute - Engaging in monetary transactions in property derived from specified unlawful activity: whoever knowingly engages or attempts to engage in a monetary transaction in criminally derived property of a value greater than $10.000 and is derived from specified unlawful activity, shall be punished (see Addendum for complete text of the section).

This definition covers not only the concealing of the origin but also the hidden existence of the illicit money. Such definitions imply that any way of hiding stolen money (or objects), including under the mattress at home (or lying as will be noted further), could constitute money laundering.

The US Money Laundering and Financial Crimes Strategy Act of 1998[101] focuses on the 'movement' element as a description of money laundering and related financial crimes:

> "*[. . .] the movement of illicit cash or cash equivalent proceeds into, out of, or through United States financial institutions*" (see 31 U.S.C. 5340(2)(A))

The US National Money Laundering Strategy of March 2000 provides a similar definition:

> "*[S]omeone who conducts a financial transaction with knowledge that the funds or property involved in the transaction are the proceeds of crime, and who intends to further that crime, or to conceal or disguise those proceeds, is laundering money.*" (US Administration, 2000, p. 5)

This description (formally it cannot be called 'definition') equally lacks clarity. The furthering of the crime or, as formulated in the 1986 Act, promoting the carrying on of specified unlawful activity, can also mean reinvestment of the crime money in the commitment of another offence. Thus a drug dealer who buys drugs with his criminally derived money is committing a laundering offence. This is also the case if he buys a vehicle (boat or car) to smuggle the contraband and/or if he pays the driver or a courier to complete the smuggling task.

The US approach of ever broadening the meaning of money laundering and expanding the international outreach of US legislation was reinforced with the USA PATRIOT Act.[102] It was introduced in 2001, shortly after the 11 September terrorist attacks. The USA PATRIOT Act was adopted to strengthen anti-money laundering measures in an attempt to counteract terrorism. Charles Doyle, in a 2002 Congressional Research Service Report relating to the US PATRIOT Act, gave the following interpretation of money laundering:

101 The introduction of the Money Laundering and Financial Crimes Strategy Act was aimed at developing a stategy to coordinate and concentrate law enforcement efforts in certain areas where money laundering and related financial crimes were extensive or presented a substantial risk (see FinCEN's website, section "HIFCA").

102 The acronym stands for "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001" (Public Law Pub.L. 107-56).

> "*In federal law, money laundering is the flow of cash or other valuables derived from, or intended to facilitate, the commission of a criminal offense. It is the movement of the fruits and instruments of crime. Federal authorities attack money laundering through regulations, criminal sanctions, and forfeiture. The [USA PATRIOT] Act bolsters federal efforts in each area*" (Doyle, 2002, p. 3).

This interpretation again appears to lack the main idea of the money-laundering concept: that the aim of money laundering is to ensure a legitimate appearance of the crime-money. This description is just about the movement or flow of money to facilitate crime. If we relate this to corruption, paying a bribe is also laundering: 'facilitating the commission of a criminal offence', resulting in a confluence of offences as was already indicated above. That means that any offence, the execution of which requires paying for expenses to be incurred, implies laundering, irrespective of whether that offence will succeed and bring in profit. Could a failed crime for profit (an attempted offence) also be prosecuted as an attempt to launder, if the two are so connected? Applying strict logic, the answer must be "yes".

Considering the history of money-laundering control in the USA, we should not be surprised that in the end the legal definition of money laundering has become so broad as to cover, finally, the mere shifting and transporting of illicit money. As reviewed earlier in this thesis, the US Bank Secrecy Act (BSA) of 1970, which supposedly helped detect crime-money flows, was largely designed to address tax violations, particularly money flowing out of the country. However, it did not succeed in halting this outflow. Therefore, as the Act was not particularly effective, whether it concerned tax evasion or laundering, it was decided that the definition of laundering had to be broadened (as discussed earlier in this thesis).

However, even if the broad definition is imprecise, clearly it fulfils a law enforcement objective, as noted above. Equalling money movements to money laundering and criminalising it enables regulators to scrutinise a wide range of activities, both domestically and abroad. With this penal clause the authorities could tackle the large cash flows within the US and particularly those leaving the country. The large money flow related to the reported cocaine consumption boom in the USA may appear to have served as a good pretext. Indeed, it was certainly a generally applauded target. It needed little justification to launch a war on drug-money laundering in which there was little attention to subtle definitions. The wider aim – raking in tax money – remained at that time in the background, but was certainly not forgotten. Ultimately, tax evaders would experience the effect of the broad definition, which fate they became bound to share with all sorts of economic criminals. So, originally, the tune of propaganda conveniently took the pitch of the war on drugs song in which the accuracy of the legal definition was subordinate to reaching the ultimate target: global acceptance. The USA, as the main driving force behind international legislative developments, set this tune (as it did in the past nine decades) and, because other countries followed suit for reasons of (international) political acceptance, it also determined the global model for fighting money laundering.

3.2.4. Reference to the predicate crime

While during the 1980s, money laundering was understood mainly to relate to drug proceeds, during the 1990s policy makers expanded the scope of the definition by pointing out that the origin of laundered funds can be a range of predicate crimes.[103] The US National Association of Securities Dealers, Inc. (NASD)[104] provides the following definition (2002):

> "*Money laundering is the process of disguising illegally obtained money so that the funds appear to come from legitimate sources or activities. Money laundering occurs in connection with a wide variety of crimes, including illegal arms sales, drug trafficking, robbery, fraud, racketeering, and terrorism.*"[105]

In a strict sense, here we are not dealing with defining a meaning (of laundering) but delineating its circle of application. Here we enter the area of criminal policy making which should not be confused with determining the correct meaning. However, in the documented discussions this line between delineating meanings and the circle of application is regularly blurred (as is evidenced by the inclusion of terrorism).

Seriousness of the predicate crime

The policy making question concerns the kind of crimes that should be qualified as 'predicate' to money laundering: only 'serious' crimes, offences committed by 'organised crime' groups, or any kind of profit-seeking crime, including tax evasion. The range of political choices is broad. Some might argue that evasion of inheritance tax, or tax on dividends is not as serious a crime as child

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103 As mentioned earlier, the 1990 Council of Europe Convention expanded the definition of money laundering beyond that laid down by the 1988 UN Convention, which defined laundering in association with drug-related offences only.

104 Succeeded by the Financial Industry Regulatory Authority (FINRA) in 2007.

105 Derived from online sources, therefore, no page number is available.

pornography. But why are things the way they are? The answers depend on political choices: every crime for profit can be rated as 'serious'. For decades researchers in the area of fraud have observed that policy makers have merely paid lipservice to the seriousness of white-collar crime and fraud while concentrating on illegal drugs trade.[106] A recent report prepared by the UK authorities states: "*As far as the relative scale and significance of the threats, it is still the case that most of those identified as involved in organised crime are engaged in drugs trafficking and distribution. The profits to be made from drugs up and down the supply chain continue to attract criminals of all levels. They support criminal lifestyles, sustain the drugs trades, foster other criminal activities, and fuel acts of extreme violence. The harms caused to individuals, to families, to communities, and in some instances to states, are often only too visible. However, it is important to recognise that drugs have been a priority for law enforcement in the UK and overseas for many years, and as a result more is known about the drugs threat than about, for example, organised immigration crime or fraud, the true scales and significance of which are therefore harder to assess*" (SOCA, 2009/2010, p. 5).

According to Palmer (2001), an expert in international documentary fraud, it seems indeed that over the years little attention has been paid to fraud and for many years banks have preferred to assume the cost of fraud (and share the cost with other banks) rather than report fraud and seek litigation as a solution. It appears that during the 2000s this situation has started to change as the amounts involved in fraud have become increasingly higher. Furthermore, the fall of the Berlin wall arguably signified a new wave of enlargement of the European Economic Community:[107] another dimension of fraud - fraud against EU funds - was (again) firmly placed on the political agenda. The European Commission forced the EU Member States to recognise fraud against EU funds as important as defrauding the national fund.[108] The repetition of this statement is an indica-

106 Lately also on human trafficking.

107 The European Union (EU) was established by the Treaty of Maastricht on 1 November 1993. The Maastricht Treaty changed the name of the European Economic Community to "the European Community". From 1 December 2009 date of entry into force of the Lisbon Treaty, the title of the "Treaty establishing the European Community" is replaced by "Treaty on the Functioning of the European Union" (Treaty of Lisbon article 2§1). The EU succeeded the European Economic Community (EEC) established by the Treaty of Rome in 1957 which in turn had been preceded by the European Coal and Steel Community formed among six countries in 1951.

108 EC Treaty Article 280 (ex Article 209a): (2) Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests. (Treaty establishing the European Community (Nice consolidated version) - Part Five: Institutions of the Community - Title II: Financial provisions - Article 280 - Article 209a - EC Treaty (Maastricht consolidated version) - Official Journal C

tion of the shallowness of the feeling of seriousness. The assimilation principle is not necessarily productive where it is based on varying perceptions of seriousness. As Tupman (1996) notes, in the UK for instance, the Serious Fraud Office may not investigate frauds below a certain threshold,[109] because of the high costs involved in investigating and prosecuting fraud. This also applies to authorities in other countries. Law enforcement resources will be allocated to matters considered a priority but prioritising is often dependant on political choices, which in turn may be a variable of economic circumstances (and often, of their byproduct, the popular mood, or, in other words, the dictate of the election period). Thus, although tax evasion has always been a priority for all governments, as soon as the credit crisis began to spread in 2008 and set the financial system alight, policy makers found themselves in a position that conveniently enabled them to reinforce the belief that hiding the proceeds of tax evasion was a serious thing. Hence, evading inheritance tax and hiding the proceeds in a sunny tax holiday island has moved up the ladder of seriousness. And so has other fraud, following Stanford's and Madoff's exposure.

The dependence of the perception of seriousness on political choices is most obvious in the case of corruption. Hence prosecution of laundering the proceeds of corruption becomes a variable of political choices too. We see this happening every day.

The 'organised crime' connotation

As we noted earlier in this chapter, seriousness cannot be part of the empirical definition, unless it can be precisely measured. Despite that observation, in the policy making discourse money laundering is often associated with the perpetration of 'serious' crimes committed by 'organised crime groups' or, by what they are often equalled to, the Mafia. Werner (1996), for instance, links the definition of money laundering to 'organised crime'. According to him, money laundering is a consequence and prerequisite of 'organised crime', since it helps criminals integrate their illicit proceeds into the legitimate economy and commit new crimes. Indeed, as elaborated in previous sections, the message of the global anti-money laundering propaganda has been that fight against money laundering is the best way to fight drug trafficking and 'organised crime'. In its

325, 24/12/2002 P. 0145 – 0146; Official Journal C 340, 10/11/1997 P. 0293 - Consolidated version; Official Journal C 224, 31/08/1992 P. 0074 - Consolidated version;http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E280:EN:HTML, 12002E280).

109 At least at the time, according to sources at the SFO interviewed by Tupman (1996), this threshold was £5million.

Presidency Conclusions of 15 and 16 October 1999 the Tampere European Council stated: "*Money laundering is at the very heart of organised crime. It should be rooted out wherever it occurs.*"[110] Early anti-money laundering legislation was largely aimed at reaching the money of organised crime groups. As these groups are supposed to have a huge financial capacity which one way or other has to flow through the financial system, this angle is not overly irrational. However, it is not new either: the argument – based on insufficient evidence brought by policy makers – being used for decades has become a 'historical classic' by now.

Nonetheless, whether for opportunistic reasons or not, the connection between laundering and 'organised crime' in the laundering definition is put forward regularly and politically readily accepted. Nonetheless it remains misleading because it would incorrectly narrow down the meaning of this concept, by connecting it to another vague and ill-defined concept that attracts all sorts of emotional associations (Van Duyne and Van Dijck, 2007b). In addition, large-scale earnings that may need laundering are not the exclusive prerogative of 'organised crime' groups. For instance, corporate and bank fraud can be committed single-handedly and can yield a massive income. But the accumulation of 'convincing vagueness' only increases the distance to clarity.

Varying financial results

Not only the 'organised crime' connotation attached to the money-laundering concept creates vagueness. There is also uncertainty as to the right application of the laundering definition with regard to the varying financial results, both of 'organised crime' and 'non-organised crime'. For instance, in the case of child pornography, regardless of the level of organisation, it is clear that all proceeds from this offence are illicit. Hence, all proceeds (perhaps minus expenses) can potentially be in need of laundering. However, in the case of evading tax (on licit income), the resulting crime money is not the total sum subject to tax, but the resulting illegal tax saving. For instance, an income of 1.000 euros may be perfectly legal but not having paid 30% income tax results in an illegally saved amount of 300 euros. In addition, even where it is clear what portion of the financial result is illegal proceeds, there is uncertainty as to whether proceeds should mean 'net profit' or 'gross receipts'. For instance, in the US the term 'proceeds' is not defined in the money laundering statute. However, despite the ambiguity of the law, for more than twenty years it has been commonly as-

[110] European Council (1999), Section X, paragraph 51 (online retrieved).

sumed that the 'proceeds' are the 'gross receipts' (including tangible and intangible objects) from an offence (for relevant case examples see Cassella, 2009). As a result, US sentencing practices abound of examples where defendants have been sentenced for promotion money laundering, even though the alleged transaction entailed nothing more than just a payment of a necessary expense for the underlying crime (particularly in cases of a (partial) merger between the laundering offence and the underlying offence) (see Cassella, 2009). In short, criminal business expenses constitute laundering too. It seems that a recent court decision (United States v. Santos, 128 S. Ct. 2020 (2008)) has now reinforced the uncertainty as to whether the term 'proceeds' should be construed as 'net profits' or 'gross receipts' (the term 'proceeds' was construed as 'net profits' in the case of United States v. Santos which will be discussed again later in this thesis[111]).

Predicate crime and laundering intermingled

In addition, the laundering definition has been broadened to such an extent that it makes no clear separation between the laundering act, which is supposed to be subsequent to the predicate crime, and the predicate crime itself. Laundering and committing the predicate crime become intermingled. This does not only apply to the smuggler who spends his crime-money on buying a truck or vessel for his newly planned undertaking. This combination is particularly to be found in economic crime and fraud. Invoicing for the provision of fictitious services can be a predicate crime, *i.e.* a way to earn money illicitly (for instance through corrupt public procurement deals), but such invoices can also be an instrument for laundering money that had already been earned, for instance through drug dealing.[112] While in the latter case the laundering act, *i.e.* the invoicing, and the predicate crime are separate acts, in the former case (corruption and procurement fraud) the predicate crime and the laundering act coincide. This means that the perpetrator of the predicate crime can also be charged

111 See section 3.2.8. An empirical analysis of the application of the definition.

112 Sometimes, the line is blurred not because of the broad definition but by the nature of the predicate offence. An employee, who has access to the company bank accounts, can embezzle company funds by simply transferring them to an account of his own and can continue to do so until someone notices the missing funds. But the offender can also create bogus procurement contracts in the name of sham firms and cronies, for example, for the delivery of stationery that is actually never delivered. As the dishonest employee has sole responsibility for this, it may go unnoticed (at least for some time) 'as valid' reasons are given for payments, *e.g.* money 'paid for large stationery orders'. The employee's associates could also have money in their account that has come from an apparently legitimate source, *i.e.* the sale of stationery. This is the perfect way to launder the embezzled funds. The problem arises if the employee is asked to account for an undocumented increase in wealth in the absence of a valid reason, for example, inheritance.

with money laundering, on the basis that he has handled crime assets and has sought to conceal the traces of his crime with the very same instrument (false invoices) with which he committed the predicate offence. Van Duyne (2003b, p. 72) calls this "*canned laundering*". Van Duyne *et al.* (2005) elaborated this problem in an example of combined corporate and income tax fraud: the fraudulent corporate tax papers being the fraud annex laundering instrument, which were again the fraud instrument for the income declaration.

One may wonder about the potential consequences of such over-stretching of the laundering definition or its overstretched logical implications. One of the consequences can be observed in sentencing in penal law systems where there is maximum penalty for laundering that is higher than for (some) predicate offences. For example, the maximum penalty for laundering is six years imprisonment and for theft, embezzlement or tax evasion the penalty is four years.

3.2.5. The three-stage model

An important input made by the US Customs Service (see Bongard, 2001) to the conceptualisation of money laundering is the description of the phenomenon as a process of three possible stages:

- placing the money with a financial institution (or introduction into the economy); then
- layering it in several different amounts through a series of transactions ("*giro-criss-crossing*", as Van Duyne (2003b) describes the avalanche of money transfers to numerous accounts) in order to take it away from the criminal source and blur the paper trail; and subsequently
- integrating the money into the legitimate mainstream.

This description designed by practitioners illustrates how money-laundering processes usually run when the money had originated in a *cash*-based underground economy. However, in addition there is a range of white-collar and economic crimes such as VAT fraud, subsidy and investment fraud, and corporate and income tax fraud, where there is no need of placement but instead it is needed to take the money out of the domestic financial system, for instance to a safe account abroad (which is closer to 'displacement' rather than 'placement').[113] In cases of elite crime such as the Enron, Madoff and Stanford cases, the criminal money management process does not start with a bank deposit,

113 For instance, in cases of VAT fraud or social contribution fraud by employers the 'white' income tax form is in the end also a laundering instrument.

because the money is already in the bank, *e.g.* as corporate funds, or money wired to the perpetrator by the victim, or illegal tax saving or as a criminal saving of business expenses (for instance, social security contributions or environmental cost saving).

As reviewed earlier, originally the anti-money laundering regime was aimed to halt the proceeds of tax evasion. But eventually, for political reasons, it began to target mainly (lower class) traditional crimes-for-profit the proceeds of which are in cash.[114] (Needless to say that cash from both drugs trade and tax evasion[115] was often dumped offshore, including in the Bahamas, in order to be safely deposited with banks there and avoid leaving a money trail, see Robinson, 2003). As the competent law enforcement agencies, *e.g.* the Customs and the DEA, frequently target these amounts of cash entering the financial system or leaving the country, it is understandable they produced this limited three-stage model. Its application should not be underestimated, although it is not intended to be a definition and, therefore, lacks a proper theoretical frame. Once introduced, this model was spread by the same uncritical 'copy-paste' procedure which had characterised the spreading of the money-laundering offence formulation. This has not furthered to develop a more realistic insight into more sophisticated forms of laundering.

Firstly, the described process does not explicitly include the most important phase of money laundering: the phase of *justification*, where the money launderer achieves his ultimate goal of a 'clean' appearance of the money. Indeed, according to some official interpretations (see for instance The Secretary of Treasury *et al.* Report to Congress, 2002), during the integration stage, crime money is being converted into apparently legitimate earnings.[116] However, neither layering nor integration, or intermingling, illicit with licit money *per se* leads necessarily to such a conversion. More than that is required, because otherwise a net-worth analysis (Albanese, 1996; Abadinsky, 2002), such as the one that Lansky was subjected to (Lacey, 1991), could potentially establish the excess of money of unaccountable origin.

Secondly, this description dismisses the possibility that in fact a 'clean' appearance of crime money can be achieved prior to the placement stage or in

114 It appears that the anti-money laundering measures were conveniently high-jacked by the DEA which during its investigations hit on large cash flows. After all, the FATF has been launched to fight drug money. But the regime serves them all quite well.

115 For instance, skimming in casinos, mentioned previously.

116 Although such scenarios are possible: the money has only entered the licit money flow between banks, *i.e.* has jumped over the layering stage straight into the integration stage or the conversion has taken place during the layering stage.

ways that do not necessarily involve placing the money with a financial institution (or introducing it into the economy) or layering it through a series of transactions. The money can stay locked in a safe at home, accompanied with a forged invoice that shows a legitimate origin. Before being used, *i.e.* introduced into the legitimate economy, the money will already be laundered, apart from the seeping of crime-money through the daily living expenses. The problem is that the entry into the legitimate financial system, or the placement stage, is sometimes the most difficult or rather risky step in the crime-money management process. Under increasing pressures for due diligence procedures financial institutions have tightened their know-your-customer rules. Thus, criminals operating in the cashed based crime-economy have become most vulnerable to detection at the stage where they have to enter the financial system. Therefore, they often have to resort to means, such as fictitious commercial transactions, fictitious contracts signed by notaries, setting up shell firms, nominee relationships and so on to ensure some initial disguise, if not as yet a perfect legitimate appearance, prior to entering the financial system.

It is a plausible assumption that in much of the crime-economy such detours and disguises are not even considered. If, for example, we were to consider the investment of illicitly derived $8.000 in a small music-shop, risk of detection at the placement stage would be minimal. As this is beneath the reporting threshold, it is unlikely that anyone would require proof of licit origin, even if the money is run through the financial system. So this is an example where the illicit origin of the money does not necessarily have to be 'masked' or layered for the money to enter the legitimate system and integrate with licit money, *i.e.* placement and integration occur concurrently. On the other hand, if the 'loan' (*i.e.* the crime-money) to the music-shop has to enter the books of that firm, this may expose the 'lender'. Examples, summed up by Van Duyne (2003b), illustrate handling of crime-money without laundering techniques. Even fraudulent businessmen resorted much less to laundering techniques than expected: they simply took the proceeds of fraud out of their firms to spend it on their personal indulgences rather than laundering it for reinvestment.

Even if not laundered, strictly speaking, crime money can be deposited with an offshore bank just to avoid tax, which is an element of the money management process rather than part of a process aimed at ensuring a legitimate appearance (but is still laundering in broad terms).

Furthermore, if we take the three-stage model as a yardstick for comparison, we will see that some existing definitions (including official ones) centre primarily on the placement phase. For instance, if we are to interpret the US

Money Laundering Control Act of 1986 (see Addendum), placing the money with a financial institution, knowing that it is the proceeds of unlawful activity or intending to promote unlawful activity, already constitutes a money-laundering offence because the act of placement is implied in the meaning of transaction.

As a matter of fact, as soon as the money is placed with a well-known financial institution (media reports abound with examples of fraudsters and corrupt politicians who manage to slip through the fire-wall and place their tainted proceeds with reputable banks[117]), the money can already be viewed as part of the legitimate mainstream, *i.e.* as integrated into the licit financial system. It is a different story if the money is placed with an offshore bank of questionable reputation. Money placed with an obscure offshore bank may raise a few eyebrows. Therefore this money may need to undergo a series of transfers before it reaches the safe shore of a reputable institution, *i.e.* the stage of integration. Yet, as mentioned above, *integrated* does not necessarily mean *laundered* in the strict sense, *i.e.* looking perfectly legitimate.

Moreover, the three-stage model is not consistent with the logic of the broad definition that describes as laundering the mere keeping/hiding of crime money at home, right under the proverbial mattress. Additionally, one may wonder where criminals' daily expenses fit in. Crime-money spent on daily needs, for example buying foodstuff in food-stores, penetrates the legitimate economy as it integrates into the legitimate economic turnover. Indeed the three-stage model has not been prepared with the ambition to cover all possible situations. The UK Crown Prosecution Service, for instance, notes (on its website) that this model applies only to "*most sophisticated money laundering schemes*",[118] apparently measuring sophistication from an intellectually low bottom line. It appears that the three-stage model lacks sophistication as events can take place outside of its remit, where legitimate appearance is invented and ensured at the end of the process - or even the beginning, inventing 'legitimisation' before the three stages commence. A sophisticated fraudster would plan the laundering route. As discussed earlier, many sophisticated schemes would most likely involve some form of pre-wash before placing the money within the financial system.

117 It seems it is mainly white-collar elite crime that manages to slip through the money laundering detection system with little or no difficulty.

118 See UK Crown Prosecution Service's website (posting updated 15 September 2010), section Principle. Introduction to Money Laundering.

Although designed from a very basic, cash based underground economy perspective, the three-stage model remained the prevalent conceptual framework and, to an extent, stood in the way of developing further ideas of criminal money management in more elaborate economic crime schemes.

3.2.6. Money laundering and political financing

The lack of precision of the term 'money-laundering' and its over-stretched application are quite evident in the case of political financing. Where a campaign is being financed with crime-money, the case is relatively straightforward. The picture becomes more complicated when a legitimate origin of funds has to be concealed or licit funds are being used in an illegal or semi-legal way to finance political campaigns. In that case the term 'money laundering' is applied to describe the techniques that are used to cover up the flows of money. Liddick (2000, p. 111) notes:

> "*In order to circumvent restrictive contribution and spending limits and to conceal the source of contributions, campaign finance solicitors, contributors, and brokers from both sides of the political aisle engaged in a variety of illegal schemes best described as money laundering.*"

The slush funds of Nixon (discussed earlier) or those maintained by the CDU party under former German Chancellor Helmut Kohl[119] are a perfect illustration of these schemes.

Funds contributed over the spending limits, even if from legitimate business, have to be subjected to a series of transactions to circumvent these limits. However, the use of money laundering techniques does not necessarily mean that laundering, in the strict sense, is taking place. This is different, if the use of money laundering techniques involves illegal means such as documentary fraud. In that case the money becomes tainted, although not necessarily in need of subsequent 'whitening' because the fraud achieves that. However, the money is nevertheless tainted and, therefore, under the broad money laundering definition, any further use of these funds is laundering. As discussed earlier, the follow-up fraudulent acts that are designed to hide something, whether some

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119 In the late 1990s-early 2000s revelations emerged about illegal funding of the German Christian Democratic Union (CDU) under Kohl's leadership. Investigations revealed that part of the funds came from the privatisation of the Leuna oil refinery in East Germany. Allegedly, Leuna was sold to French oil company Elf Aquitaine in a corrupt deal arranged by Kohl and the late French President François Mitterrand (Nübel, *TAZ*, 2010). It has been reported that Kohl avoided trial by paying a fine of DM300,000 for receipt of illegal party donations (*Birmingham Post*, 2009).

minor irregularities, civil infringements, corruption or perfectly legitimate activities, create a 'hereditary' chain of laundering actions (Van Duyne *et al.*, 2005, to be discussed later). In such cases it is not clear at what stage the money can be considered as derived from crime. But somewhere in the chain of concealing transactions such a transformation takes place.

A less traditional rationalisation but one that offers political convenience, is the definition suggested by Yordan Sokolov in 2000. Sokolov, a senior political figure in Bulgaria, then chairman of the Bulgarian Parliament, interpreted the term 'money laundering' as follows:

> "*Money laundering is a form of circulation of money that is either of 'dirty' origin or is handled by a 'discredited' sender, and that eventually returns to its sender*" (see Raikov, 2000, p. 10).[120]

Sokolov's partisan statement came in defence of Elena Kostova, the wife of then prime minister of Bulgaria Ivan Kostov. At the time she was alleged to have accepted money of questionable origin. It was suggested that her foundation had accepted funds from the Russian-Israeli businessman Grigory Luchansky[121] (see Raikov, 2000).

According to Sokolov, as long as the allegedly illicit money does not go back to the donor, there is no money laundering. Such a definition, however, would open the gate for criminal party funding and corruption. The practice of donations for 'good causes' by businessmen who derive their money from questionable activities has a long history and, depending on the nature of the transaction, it often represents the perfect way of legitimising tainted funds. Lansky's gambling business thrived on such donations (see Lacey, 1991). Donations can be made to ensure certain economic advantages, for instance preferential treatment in privatisation, or simply to ensure support for whatever reason.

In any case, it seems that the danger of having a broad and ill-designed definition is that it allows room for convenient, self-serving interpretations not just to the advantage of law enforcement authorities but also to those who may want to circumvent the law.

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120 This is translated from Bulgarian.

121 According to media reports, Grigory Luchansky, often described as controversial, has alleged ties to organised crime and has been investigated in many countries (Tavernise, *The New York Times*, 2003; Warner, *Financial Times*, 2004; Ryle and Magnay, *The Sydney Morning Herald*, 2007).

3.2.7. Politically accepted international definitions and assumptions

Legislative developments – a recap

Let us summarise the chain of legislative events leading to the global penalisation of handling crime-money under the denomination of laundering. After that, we will dissect the definition to the bone.

- The USA triggered international developments in the area of anti-money laundering regulations. First, the national legislation was put into place.
- Then the foreign campaign started, beginning with the UN, where the US influence was paramount. The Vienna Convention,[122] drafted at the initiative of the USA and largely based on concepts developed in the USA, set the pattern for the subsequently internationally adopted legal definitions of money laundering. However, although the convention defined the offence, it did not explicitly name the offence: 'money laundering'. But all knew its name: all subsequent legislative documents, particularly the Strasbourg Convention and the EU Directives, copy-pasting the Vienna Convention's definition almost verbatim, called it 'money laundering'.
- The US approach of defining money laundering as broadly as possible, so that covering the mere concealment of the location of property knowing it is from a criminal source (in the Vienna Convention restricted to drug offences), was copied by the Vienna Convention and then further enforced by the FATF Recommendations and all subsequent international documents.
- The Basle Statement of Principles (1988) similarly extends to all aspects of laundering techniques, including the mere concealment of location, but through the banking system, *e.g.* by means of deposit or transfer of money derived from illicit activities.
- The definition of the laundering offence under the Strasbourg Convention and the EU Directives, real imitations of the Vienna Convention's provision, but with the important gradual extension to all forms of crime, and explicitly stating that *assisting* money launderers is also a laundering offence (see Addendum, paragraph (d) of the definition in the US Act).[123]

122 The 1985 United Nations Congress on the Prevention of Crime and the Treatment of Offenders had also laid some foundations in this direction (see Van Duyne and Nelemans, 2011).

123 This now entails the whole financial consultancy sector, from single tax advisors to major consultancy firms, and also some professions outside the traditional financial sector such as real estate agents and casinos. As mentioned previously, this extention was gradual. The First EU Directive focused on the traditional financial services sector and on fighting the laundering of proceeds from drugs related offences. The Second EU Directive extended the scope of predicate offences and sectors obliged to report suspicious transactions.

Now that we have seen the outer surface of the 'definitional union', we will peel it off, layer after layer. The definition contains three basic elements: object, purpose and action. The action may also be passive: omitting to undertake certain measures required by law (and often also by public morals). The action, in fact, describes the *modus operandi* of money laundering, or how it is done. These three elements constitute the formal components of the money laundering offence and represent the trinity of aim, meaning and spirit of the criminalisation clause.

Definition dissection

a. Object

The object of the money laundering offence is the criminally derived economic advantage, as defined by the Strasbourg Convention (see below). Although this advantage or gain is frequently referred to here as 'crime money' in shorthand, its forms can extend far beyond just 'dirty' cash. More generally it is described as 'any property derived from crime'.

- The 'object' evolving

As indicated before, developments since 1986 have been marked by a tendency to broaden the definition to cover any type of property.

Section 1956 of the US Money Laundering Control Act refers to 'laundering of monetary instruments' (which may reflect the worries of the time and place, *i.e.* cash flow problems facing the US authorities) meaning:

(i) coin or currency of the United States or of any other country, travellers' checks, personal checks, bank checks, and money orders, or

(ii) investment securities or negotiable instruments, in bearer form or otherwise in such form that title thereto passes upon delivery.

The focus appears to be on monetary instruments and funds, although the Act also refers to 'property'. Section 1957 defines the term 'criminally derived property' as any property constituting, or derived from, proceeds obtained from a criminal offence. These objects, *i.e.* monetary instruments, funds and property, represent the 'proceeds' of specified unlawful activity. The term 'proceeds', however, was not defined in the original text of the Act which led to an ongoing debate as to whether proceeds is 'gross receipts' or 'profits'. The debate seemed to have culminated in United States v. Santos (discussed in this thesis). Subsequently, in 2009 the US Congress amended the Act by defining proceeds as gross receipts.[124]

Through the Vienna Convention, international policy-makers began to abstract from the focus on tangible monetary instruments and to target any asset, not just their monetary equivalent. 'Property' under the Vienna Convention means assets of any kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, and legal documents or instruments evidencing title to or interest in such assets.

The Strasbourg Convention uses the term 'proceeds' meaning any criminally derived economic advantage and this may consist of any property, corporeal or incorporeal, movable or immovable, and legal documents or instruments evidencing title to, or interest in, such property.[125]

- The abstract element

The introduction of an abstract element such as 'advantage' raises the question: how 'an advantage' is laundered and does the Convention really mean any advantage, even competitive advantage? Given the provisions of the US Foreign Corrupt Practices Act (which will be discussed later), a competitive advantage gained through bribery of foreign government officials is crime proceeds and concealing the criminal origin, specifically concealing the bribery or any form of illegal payment made to gain that advantage would amount to laundering (see Gelemerova, 2010). However, if, for example, a US company gains a competitive advantage over local market players by breaking EU market regulations, is the US company laundering this advantage by covering up the offence? Here we may run into trouble. Strictly interpreted, the fraudulent US firm is laundering, but not necessarily everywhere. In some jurisdictions, price fixing, for instance, is an offence of an administrative nature and in others a criminal one. Environmental crimes can raise similar problems: the illegal dumping of toxic waste by Trafigura in around Abidjan, the capital of Ivory Coast, in 2006 (see the *Guardian*, 2009) aimed at saving processing costs which is an advantage, but where is the laundering?

124 The amendment was introduced through the Fraud Enforcement and Recovery Act of 2009 which amended the Money Laundering Control Act by defining that the term "proceeds" means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity. The Act was signed into law on 20 May 2009. It is debatable whether courts will apply the 'gross receipts' definition to cases of conduct that had occurred prior to the date of the introduction of the amendment.

125 The Warsaw Convention makes no amendments to this definition.

- The varying legal contexts

Varying legal contexts have to be taken into account too. For instance, price fixing was not a criminal offence in the UK (similar to the majority of EU jurisdictions) prior to the introduction of the UK Enterprise Act of 2002. At present, activities which undermine fair trade may result not only in civil but also in criminal penalties.[126] However, this is not the case in all jurisdictions within the EU and outside the EU. This means that in a multi-country price fixing case, one may face laundering charges in the UK, but not in Germany[127] for example.

Of course, the origin of an (unlawful, but not criminal) advantage gained via violations which are only regarded as an administrative or civil offence is not criminal. Therefore the money-laundering criminalisation clause should not apply in such instances. However, if subsequently the company was to fraudulently cover its administrative wrongdoing, then it would be slipping from an administrative into a criminal offence. Yet, if executives engage in adjusting invoices (which does not necessarily constitute documentary fraud) to settle mutual claims rather than to conceal a violation and the advantage gained through this violation, then, it seems, no laundering of the advantage would be taking place (see also example of cartel building in Van Duyne and Van Dijck, 2007a). For example, a cargo of cement is delivered at a 30% discount to settle a payment: the cement is real, the invoice is not fraudulent and is duly included in the paper work and the payment is also a real one, plus VAT. What is being laundered? This example can be extended to other areas, like environmental violations. Therefore, there is room for further interpretations and complications in cases of international legal differences.

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126 An interesting development in this regard was the Norris v USA case. In 2004, US prosecutors requested the extradition of Ian Norris, a UK national, on charges of price-fixing in the carbon industry in the US, among other countries, during the 1990s. Norris claimed that, at the time, participation in a cartel was not a criminal offence in the UK. The Enterprise Act of 2002 created such an offence. On 12 March 2008, the UK House of Lords supported Norris' claim and ruled that secret price-fixing is not itself dishonest in the absence of aggravating conduct such as fraud or intimidation. As Stephan (2008) notes, the Lords' reading of dishonesty is treated as contextually distinct, applying only to cartel conduct prior to the Enterprise Act coming into force. That aside, the case raised criticism as to the extra-territorial reach of US law with regard to conduct outside the US but with US ramifications. Failing to extradite Norris on price-fixing charges, in 2008 US prosecutors managed to obtain an extradition ruling on obstruction of justice charges. Norris was extradited in March 2010. (See Croft, *Financial Times*, 12 July 2010; Wilson, *The Daily Telegraph*, 16 July 2010.)

127 The German penal code (Strafgesetzbuch, "StGB") criminalises price fixing only in connection to public contracts (§ 298 StGB, Wettbewerbsbeschränkende Absprachen bei Ausschreibungen). Otherwise, price fixing is only an administrative offence according to § 81, Gesetz gegen Wettbewerbsbeschränkungen.

Not only in the area of what we typically perceive as economic crime are cases to be found where the predicate act is not universally criminalised.[128] The range of acts that count as criminal activities vary from jurisdiction to jurisdiction and so do the related proceeds. For example: abortion is a criminal offence in Poland,[129] but not necessarily in other EU countries. A doctor who carries out an illegal pregnancy termination for profit in Poland and who deposits the money with a Berlin bank is not necessarily punishable in Germany for the predicate offence, but may still be arrested in Germany and extradited for the laundering offence[130] (Van Duyne *et al.*, 2005).

- Implications of the broad interpretation

The EU Directive moves slightly away from the definition laid down in the Strasbourg Convention by not using the term 'advantage'. Otherwise, the directive copies the Strasbourg Convention[131] almost verbatim and the interpretation of the object remains as broad. According to the EU Directive, 'property' means assets of any kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, and legal documents or instruments evidencing title to, or interests in, such assets.

These international definitions extend the reach of the criminalisation clause beyond money or monetary instruments to any material and immaterial advantage (it is also possible to interpret the definition so that the broad term 'advantage' is covered by 'intangible' or 'incorporeal' assets).

No object of acquisition is exempt, even livestock. If A steals a cow in Poland and B helps him to transport it to Germany using false certificates to show that the cow has been bred in Bavaria, both A and B will be committing a money laundering offence: B for offering the service and A for possessing a laundered ('white') cow after obtaining the papers.[132]

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128 As mentioned earlier, the Vienna Convention refers only to drug related offences, whereas the Strasbourg Convention and the Second and Third EU Directives extend their scope to other criminal activities.

129 It is allowed only in limited circumstances, for instance, when the continuation of the pregnancy puts in danger the woman's life.

130 Under the European Arrest Warrant that would likely be enough as the extraditing court will only marginally test the request.

131 While the Strasbourg convention states more vaguely that 'proceeds' means 'any economic advantage' and that it *may* consist of 'property', the Vienna Convention says 'proceeds' means 'any property' and 'property' means assets of every kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, and legal documents or instruments evidencing title to, or interest in, such assets.

132 This happened in an extensive meat fraud in the 1990s: Polish cows had been bought in Poland, obtained a false certificate in Germany and were transported to the Netherlands, Belgium, France and Spain, destined for pretended export to North-Africa. (Van Duyne, 1993).

If A steals a sculpture from B and presents it to C as his own, this could be qualified as money laundering. The transplantation of illegally trafficked human organs and all related paperwork could also fall into the category of money laundering. Article 1.a of the Strasbourg Convention, however, attempts to reduce potential interpretation absurdity by stating that the property is proceeds, meaning any economic advantage from criminal offences. In the case of illegal trafficking of human organs, not the human organs but the payment received for them would be the economic advantage gained through crime. The nature of the payment is irrelevant. Although the organ itself is not an instrument of payment, the question is whether by-passing a national waiting list, can also be interpreted as an 'economic advantage' or criminal proceeds gained by the beneficiary of the organ. Presumably not, if this is to be viewed as an advantage gained for non-commercial purposes, *i.e.* it is not the proceeds of a crime for profit (from the perspective of the organ's beneficiary). However, there is still scope for absurd interpretations, especially given that precedents have been set of raising money laundering charges for predicate crimes that are not necessarily crimes for profit *per se*. One such example is the Russian spy ring scandal in July 2010 when a number of individuals in the USA were charged with acting as unregistered agents of a foreign government and related conspiracy to launder money. Prosecutors claimed that the defendants wilfully and knowingly conducted financial activity, including the purchase and rental of residences, using the proceeds of specified unlawful activity, specifically violations of the Foreign Agents Registration Act of 1938.[133] It appears irrelevant in this case whether this specified unlawful activity was in fact crime for profit. This raises the proverbial question what was first: the chicken or the egg. Exactly which funds constituted proceeds and how were they derived? Firstly, the defendants needed money to fund their espionage activities and simply to cover their daily expenses. The funds for this must have come from the Russian state budget, *i.e.* from a legitimate source, but were used in an illegal way (from the perspective of the US authorities). Secondly, the pay for the job also came from the Russian state budget. Presumably the alleged spies spent that money in a legal way, *i.e.* for daily expenses, leisure, but the money was earned through an unlawful activity (from the perspective of the US authorities). Which of the

133 See USA v. Christopher R. Metsos *et. al*, Sealed Complaint, 28 June 2008.

two categories of funds could be considered the object of money laundering remains a question.[134]

An essential characteristic of the subject of money laundering is its criminal origin: the property is derived from crime. This gives rise to the question whether activities such as the earlier elaborated campaign fund-raising abuse, circumvention of spending limits, concealment of the source of donations for party financing or for financing of unlawful covert operations fall into the category of money laundering if the source of funds is legitimate (compare Liddick, 2000). Such activities do involve typical money laundering techniques. Yet, as long as the funds are from a legitimate source, it seems that the money laundering criminalisation clause is not applicable. However, as noted in the previous section, once these funds have been run through an illegal scheme, *e.g.* the use of false documents, they can subsequently be viewed as derived from crime. Consequently it is crime-money. After that point, whatever is done with this money to make it 'white', should logically be qualified as money laundering. Furthermore, the investment of this tainted money into the election campaign of a political party secures an economic advantage for both the party and the owner of the money. It is arbitrary whether the tainted money that has resulted in an 'economic advantage' has been really laundered. Phrases like 'economic advantage' and the wide scope of the definition may result in much arbitrary interpretations. Unless one sticks to a logically strict interpretation, the effect is much ambiguity. Sticking to a broad interpretation leads to such a broad coverage that, it seems, it is easier to escape from Alcatraz than to escape a laundering verdict.[135]

Furthermore, not only the range of crimes but also the financial scope of crime will of course vary. But is that relevant? According to Article 1.g of the Strasbourg Convention, 'predicate offence' is any criminal offence resulting in proceeds that may become the subject of money laundering. This can be any crime for profit. Clearly a hungry man stealing small amounts of food is not committing a crime for profit. However, a gang stealing foodstuff from a supermarket to sell it later on the black market, is committing crime for profit too. This crime may be of limited scope that barely necessitates laundering in the strict sense of the term. Nevertheless, the sale of stolen goods may qualify as

134 Not surprisingly, this became a highly politicised case in which the defendants pleaded guilty to conspiracy to act as an unregistered agent of a foreign country while the graver money laundering charges were dropped in a swap deal between the US and Russia (*BBC*, 8 July 2010).

135 This appears to apply to 'small fry' rather than Mr Bigs, large-scale white collar criminals and corrupt politicians who can afford good lawyers (see section 3.2.8). It can be argued that the broader the legal definition, the weaker it is because it is easier to manipulate it.

laundering: technically the shoplifters do launder, because they sell the loot, while concealing its origin, and convert it into money. The application of the laundering definition has no *quantum limit*. Whatever, and how much, is done after the criminal acquisition should apparently count as laundering. This is not an example *ad absurdum*: it is a general experience that criminal law devices destined for 'serious' criminal offences are in the end used in minor cases.

However, the 2001 amendments (Directive 2001/97/EC) to the original Directive of 1991 raised an important point that looks like a shrinking of the broad laundering net. According to the amended Directive, Article 1.(E), the predicate crime has to be a *serious* crime. As noted earlier, descriptions such as 'seriousness' of a crime have to be defined adequately, possibly in a way that allows the measuring of the effect of 'seriousness'. According to the Second EU Directive (2001/97/EC), serious crimes include, at least, drug related offences as defined in Article 3(1)(a) of the Vienna Convention; or the activities of criminal organisations as defined in Article 1 of Joint Action 98/733/JHA; or fraud, as defined in Article 1(1) and Article 2 of the Convention on the protection of the European Communities' financial interests; or corruption; or an offence which may generate substantial proceeds and which is punishable by a severe sentence of imprisonment.[136] However, even though the authors of the directive have attempted to put the element of 'seriousness' in a specific frame and context, the definition remains broad with fuzzy edges. It is also determined by a range of politically vague concepts and interests: it is almost taken for granted that drugs are 'of course' a serious offence; the ill-conceived 'organised crime' is in every instance serious; as to EU fraud, even though it has been included by the EU Commission, it is otherwise paid relatively little attention.[137] Equally, it is unclear what type and scope of corruption offences fall into the category 'serious', or how much money amounts to 'substantial proceeds'.

In the 2005 amended EU Directive we see an attempt to define 'serious' more precisely. This time, the directive avoids the vague description "*an offence which may generate substantial proceeds and which is punishable by a severe sentence of imprisonment*" (Article 1, (E) of Directive 2001//97/EC) and replaces it with "*all offences which are punishable by deprivation of liberty or a detention order for a maximum of* ***more than one year*** *or, as regards those States which have a minimum*

136 Theft can carry several years of imprisonment. So, in some situations, shoplifting too can probably fall into the category of crimes that are predicate to laundering.

137 Except for, as it appears, when it concerns weaker countries such as Bulgaria (see reports on suspended EU funds for Bulgaria, Weaver, *Guardian*, 23 July 2008).

threshold for offences in their legal system, all offences punishable by deprivation of liberty or a detention order for a ***minimum of more than six months***" (Article 3 (5) (f) of Directive 2005/60/EC). Given the valuation of crimes for profit and the relevant punishment in the Member States, this can hardly be considered as a limitation or a more precise definition: there are hardly any crimes for profit punishable with a lower term of incarceration (and there may be some criminal (economic) offences which are not punishable by deprivation of liberty, which appears to mean that these are not included). Otherwise, Directive 2005/60/EC contains the same check-list of 'serious crimes' as Directive 2001/97/EC adding to it also acts as defined in Articles 1 to 4 of Framework Decision 2002/475/JHA, *i.e.* offences relating to terrorist activities, even though these do not necessarily generate any proceeds. Corruption continues to be listed as a 'serious' offence with no further details provided as to scope or type of corruption. But its maximum penalty exceeds one year imprisonment in all jurisdictions involved.

In any case, it is now said that the proceeds from 'serious' crime are the object of money laundering. As broad as it is, this term is of little help in understanding the laundering phenomenon. It is important to know the nature of the specific crime to be able to understand the subsequent act of laundering as it is often the specific nature of the crime, and the amount of proceeds derived from it, that predefine the laundering techniques or the way money laundering takes place: a drug baron starts from another position than a VAT fraudster. The former starts with a heap of banknotes, the latter with a tax return or a bundle of invoices. And here come the second and third elements of the definition: action and purpose.

b. Action and purpose

With regard to these elements of the definition, there is a clear conformity between the Strasbourg Convention and the EU Directives. As we have seen, they in turn copy the Vienna Convention *verbatim*, except that they include an additional, fourth part of the provision (reviewed below), which was not incorporated in the Vienna Convention.

- Laundering v. self-laundering and other issues with the recurring legal contradiction

The element of action is in fact the *modus operandi*. The definition does not require the action to be a completed money laundering cycle in the sense of providing legitimate appearance to the illicit proceeds. It can be the mere handling of the proceeds, or even possession. Furthermore, anyone involved in the handling of the property, after its illicit acquisition, can be a money launderer. This could be the person who committed the predicate crime; the person who acquired the illicit property (if different from the person who committed the crime); or an intermediary. Conceptually, most often, a third party is assumed to be involved along with the predicate perpetrator. In a way, laundering can be seen as a form of accession to the predicate crime *post factum*, which is the majority view in many countries (see Pieth, 1999).

From Article 6.2.b of the Strasbourg Convention it seems that self-incrimination is implicitly required, or at least not explicitly excluded. It states that national legislation may envisage that the money laundering offence does not apply to the perpetrator of the predicate offence. In the event that local legislation does not envisage such a possibility, the successful perpetrator automatically handles 'proceeds', unless he surrenders to the authorities immediately after committing the predicate offence in order to avoid committing a laundering offence. There is also the uncertainty about the situation in which the offender does not want to disclose where the proceeds are hidden. That is 'hiding', but qualifying this as laundering implies a violation of the non-incrimination principle. If he *lies* about the location, then he is certainly laundering.

The definition contains four, or, in the case of the Vienna Convention, three sections, which describe different laundering acts or techniques. The *first* action is:

> "*. . . the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action . . .*" (Art. 1 / 2. (a), Directive 2005/60/EC).

According to this section of the definition, even the mere transfer of property can qualify as a money laundering offence. The definition requires that any subsequent act after the illegal acquisition of the property is viewed as a laundering offence. However, it is important that the action of conversion or transfer is done with the purpose of concealing or disguising the illicit origin of the property or assisting the person involved in this activity to evade the legal consequences of his actions. This is the *third* element of the money laundering offence: the *purpose* of the action. In fact, this provision stipulates two possible purposes. One is to conceal or disguise the origin. The second possible purpose is to assist the person involved in the predicate crime to evade the legal consequences of his actions. If the latter applies, it is clear that an intermediary is involved. The person who is instrumental in converting or transferring the property may not necessarily be aware of its origin and of the purpose of the transaction. In that case, there is no 'laundering purpose' for the intermediary, so the intermediary is not committing a laundering offence, unless the negligence clauses apply: he 'should have' known.

Generally, the knowledge aspect is important: knowing that such property is derived from an offence. The clause is applicable only where the individual is aware (or ought to have been aware). For instance a bank officer should not be held responsible for any transfer of illicit funds but only for transfers where he was aware (or ought to have been aware) of the criminal origin of the funds and the purpose of the transaction.[138] This, of course, raises a major problem for those involved in the legal profession and related fields. Even the toughest criminals have the right to legal defence but their lawyers might need to defend themselves too against possible money laundering charges when they know or should have known that their client has no legitimate funds to pay for their services. This issue has been raised in a number of jurisdictions, including in Germany[139] and the USA (see the case of Benedict Kuehne discussed in the next chapter).

The second part of the definition describes the following actions as a money laundering offence:

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138 What happens if the bank officer is aware of the criminal funds but is made to believe that the purpose of the transfer is not to conceal the origin of these funds but to provide the funds to a charity foundation? As incredible as this may sound, the naïve banker will be carrying out the transaction not with the purpose of concealing the origin of the funds. Yet, his actions still may constitute a money laundering offence, as they may be qualified as criminal negligence or may be construed as assistance to the perpetrator in avoiding the legal consequences of the actions of the latter. Apart from that, he is handling crime money. Of course, in many cases, bankers are not naïve but prefer not to know (see Palmer, 2001) and not to have proper due diligence procedures in place (this subject will be discussed later in this thesis).

139 For istance in Germany, where the law has been largely based on international regulations, in 1999 the Supreme Court of Hamburg decided that the money laundering offence is not applicable to defence counsel who accepts proceeds of crime as a fee. In 2000 the Federal Supreme Court reversed that ruling. In 2004 the Federal Constitutional Court ruled that that the laundering offence can only be applied to defence counsel who *knowingly* accepted dirty money as a fee. The Court noted that the money laundering offence prevented counsel from defending clients adequately and underlined the courts' responsibility to consider the special role of the defence counsel. Critics claim that the Court does not provide clear criteria for such considerations and that the Court's decision cannot protect the defence against disturbing investigative means such as searches or surveillance (Bussenius, 2004).

“. . . *the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity* . . .” (Art. 1 / 2. (b), Directive 2005/60/EC).

Here the action and purpose coincide: *concealment* or *disguise* mean any action the purpose of which is just to conceal or disguise. Although this section of the definition seems to largely overlap with the previous one, there is one major difference between the two. The previous one refers to concealing the *origin* of the funds, while this one covers not only the *origin* (source) but also the *location* and *movement* of proceeds, and their *true nature*. While it is clear what is meant by ‘location’ and ‘movement’, the meaning of ‘true nature’ is not specified. Does this term refer to whether the property is corporeal or incorporeal; movable or immovable? Why should the concealment or disguise of the true nature be defined as money laundering? How does this work in practice? If ‘true nature’ means ‘origin’ or ‘source’, or even ‘ownership’ of property, then the clause is a tautology, unless it means that the proceeds get another identity. For example, the identity of an object is changed by changes in its appearance: giving a car a new chassis number or changing the serial numbers of stolen electronic articles.

Concealing the ownership of the property can be achieved in different ways, including the registering of it in the name of a relative. However, concealing the ownership does not necessarily imply a legal title to the property. To realise that one has to complete fraudulent owner deeds. In the case of the theft of a car or a piece of art where the proof of origin has been changed, (*e.g.* by producing a new registration number, *i.e.* changing its nature, together with forged papers of origin) one conceals the ownership in an attempt to provide legal title to the property.

The definition broadly describes the laundering offence by covering every possible action that can be construed as concealment of the source or location of property including hiding the property under the mattress or lying. But here we hit on the previously mentioned legal contradiction. The *reflexive* application entails a significant juridical problem. The ambiguity of the laundering clause means that anything the perpetrator does to conceal the criminal source of his funds, including lying or even possibly remaining silent during interrogation, can be construed as laundering (see for relevant analysis Van Duyne, 2002b). This means, as discussed elsewhere in this thesis, that the laundering clause implies or, at least does not explicitly exclude, self-incrimination, which is in conflict with the *lex certa* and the basic non-self incrimination principle of law (see Van Duyne, 2002b and 2003b). The *reflexive* application of the laundering clause implies that the perpetrator of the predicate crime cannot escape the consequential laundering offence, unless he either disposes of the crime property (destroys it – if destroying is not aimed at concealing the origin and nature of the property - or gives it back) or turns himself in (Van Duyne, 2003b and 2002b).

Furthermore, it appears that the concealment clause can be applied to anyone close to the perpetrator or self-launderer, as anyone in his closest surroundings, even if inadvertently, participates in the perpetrator's life and actions that involve the criminal proceeds. The Swiss case BGE 119 IV 59 ff demonstrates how broadly the laundering definition can be applied. In this case, the defendant let his friends hide drug money on his balcony, and later in his kitchen (initially CHF 70.000, later CHF 120.000). In addition to hiding the money, at some point he also consumed part of it. Under Article 305 of the Criminal Code the defendant was sentenced to 20 months imprisonment on charge of repeated money laundering (see Pieth and Estermann, 2002).

The third part of the definition is:

> ". . . *the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity* . . ." (Art. 1 / 2. (c), Directive 2005/60/EC).

The above mentioned Swiss case seems to be a good example of the application of this definition. The defendant used (and possessed – having it in his kitchen) the property, so he committed a money laundering offence on this point too. The action described in this provision is the *acquisition*, *possession* or *use* of the property knowing it comes from crime. This section seems to distinguish the perpetrator of the predicate crime from the person who receives the property. By adding ". . . *at the time of receipt* . . ." the legislator appears to split the act of receipt from the criminal activity suggesting that the two acts take place at different points in time.

However, the provision is ambiguous and leaves room for other interpretations as well. If we take the element of 'possession', here the act of possession, receipt and the laundering merge. Even if laundering is not intended, as long as the perpetrator is still in possession, he launders assuming the *reflexive* application. For instance, in the Swiss case above, if the owner of the proceeds shared the flat with the friend that let him hide the money there, he would be laundering the proceeds, assuming the *reflexive* application.

In addition, one may argue that receipt is acquisition, and acquisition can be theft. Therefore the thief and the person who 'receives' the property can be the same person which is a tortuous legal interpretation and contrary to usual semantics, but fully, and on purpose, adopted in many jurisdictions (even though, according to the Convention, the criminalisation of self-laundering is optional). For instance, in the Netherlands, until 2001, law enforcement agencies considered it as a defect that a 'self-launderer' could not be prosecuted, because the penalisation of laundering was contained in the clause concerning receiving. So police and prosecution pressed for criminalisation of the act of self-laundering. Whether this was so urgently needed, remains debatable. In contrast to the Netherlands, the Austrian penal law, for instance, and to an extent, the Swedish system, does not incriminate self-laundering.[140] However, financial institutions in Austria are obliged to report if they suspect self-laundering, for the purpose of detecting crimes. In the UK a criminal can be prosecuted for 'own proceeds laundering' or self-laundering and, in fact, there have been a number of high-profile cases, where money laundering was the sole charge that could be proved or the easiest charge to prove without having to wait for a conviction in relation to the predicate crime (see for instance the Terry Adams case which will be discussed in a later section). According to UK law, in 'stand alone' money laundering prosecutions it is not necessary to wait for a conviction in relation to the underlying criminal conduct, and in any case, circumstantial evidence of association to crime (no need to prove a specific act) is sufficient to prove that the laundered assets are the benefit of 'criminal conduct' (the same applies to the Netherlands). The problem with this is that law enforcement officers and prosecutors seem to view this as quite a satisfactory result: if they manage to put someone behind bars for money laundering, they view this as a victory in their fight for justice. Criminals, however, may also be happy, as in some (albeit rare) instances they can get away with a lighter sentence for the laundering charge rather than for the predicate crime (unless the laundering offence carries a higher punishment).

An interesting recommendation, but one that sounds ambiguous and is hardly followed, was made by MONEYVAL (Council of Europe Select

[140] In Sweden, as a result of a Supreme Court ruling, self-laundering in the form of receiving the proceeds of crime offence is not separately punishable but is "co-punished" with the predicate offence (if the latter can be proven). As a result, when evaluating the Swedish system, in its 2006 report the FATF concluded that the predicate offence could be considered as an aggravated offence and could result in higher penalties. The FATF noted that the Supreme Court's ruling did not explicitly indicate whether punishing of self-laundering would be in breach of the Constitution or fundamental principles of Swedish law (FATF, February 2006).

Committee of Experts on the Evaluation of Anti-Money Laundering Measures formerly known as PC-R-EV, a FATF-style regional body) in its 2000 annual report. The report states: "*[A] number of the prosecutions, of which the examiners were aware, appeared to involve charges of 'own funds' laundering, brought together with charges against the same defendant for the predicate crime. The appropriate authorities must guard against prosecuting self-laundering at the expense of bringing money laundering proceedings independently against and affording priority to separate investigations involving professional money launderers.*" (CDPC and PC-R-EV, 2001, pp. 32-32). It is not entirely clear what this means but it sounds as if MONEYVAL are afraid that only the 'easy' cases of self-laundering are being prosecuted. This fear is not imaginary: there is a tendency with the public prosecution to go for easy charges which have a greater likelihood of conviction than the more complicated one.

- Implications of the awareness element when *using* the property

In the event that there is no self-laundering, *i.e.* the person who receives the property is different from the predicate perpetrator, as was the case with the defendant in the Swiss example above, this person would be committing a laundering offence if he was aware of the criminal origin of the property. However, it is not quite clear whether the receipt of the property has anything to do with concealing the origin of the property. The purpose of the *receipt* and *use* of the property may well be the disguise of its illicit origin, but not necessarily. The property can simply be used for its convenience. Someone who is living in the house of a mafia 'kingpin' for a month or two, enjoying the luxury of it, might be committing a money laundering offence: he is 'using'. Just swimming in the pool owned by the mafia head would constitute use of property knowing it comes from crime. It could be said that staff who are aware they are being paid out of criminal proceeds are also committing a laundering offence - as previously noted, this includes legal services hired by the launderer and being paid with tainted money (see the case against Kuehne discussed in the next chapter). However, the definition, as laid down in the Convention and the Directives, is preceded by an introductory note which states that the conduct must be committed intentionally, *i.e.* with *mens rea*. Logically this should mean that the person who uses the property is not committing a money laundering offence as long as he has no intent to launder the property. According to the basic principles of criminal law, the intention (*mens rea*) consists of two elements: knowledge and will. If the ultimate purpose of a money laundering offence is to cleanse the property from any indication of illegitimacy, the person who is carrying out the action is committing a money laundering offence only if this person knows about the ultimate 'cleansing' purpose of the action and wishes it, or at least accepts its potential outcome. However, according to the money laundering definition, laundering is not necessarily aimed at providing a legitimate appearance to the property. The definition states that *anything* from movement to use and possession of the property can be qualified as laundering. This appears to imply that intent to *launder* is the same as intent to *use*. Laundering is such a broad concept that it turns into a vicious circle: knowingly and wilfully using the assets, like the luxurious assets of a criminal, implies intent to *use* but *use* of a criminal property is laundering. Hence intent to use a property can potentially qualify as intent to launder. As it appears, the ultimate purpose of 'cleansing' is not necessarily part of the definition which means that the circularity is perfect and, as a result, knowingly using the property without purpose (*i.e.* the purpose of cleansing) is sufficient. Therefore swimming in the swimming pool of the crime-boss entails laundering, similar to the Swiss defendant knowingly using part of the hidden money. The same applies to the husband/wife of a social security fraudster: using the items and facilities of the household expenses paid from the fraud can be qualified as laundering. The intent to launder and the action of using appear to have become fused. Unless intent concerns only the ultimate purpose of laundering in the strict sense of the term, knowingly using, *inter alia,* is using with intent to launder in the broad sense of the term. Therefore, the application of the definition becomes overstretched and incoherent. The ultimate laundering intention (of 'whitening' or 'cleansing') has evaporated. Consequently the intent is now focused on all other components of the clause.

Furthermore, under the broad laundering definition we are bound to make little difference between the 'intent' to launder and 'knowing that a property comes from crime'. Both will be considered as different wordings of intentionality, although knowing is weaker. Additionally, the threshold for proof is almost levelled between 'knowing' and 'should have known'. Article 6.3 of the Strasbourg Convention suggests that national legislators can also criminalise negligence ("*ought to have assumed that the property was proceeds. . .*"). In the example discussed earlier, if negligence clauses applied, the bank officer would have probably been charged with money laundering.

It seems that legislators have drafted a broad and ambiguous definition, the application of which becomes an activity tautology. Yet this appears to be of little concern to legislators, as there is little opposition from legal science[141] or criminology, while law enforcement agencies naturally welcome any increase of their powers. Whether it borders on arbitrariness is of less concern.

- Further ambiguity: abetting the *use* of property

The fourth action described in the definition, particularly in the Strasbourg Convention and the Directives (but not included in the Vienna Convention), is:

> "*. . . participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing points*" (Art. 1 / 2. (d), Directive 2005/60/EC).

This section of the definition focuses on the actions of an accessory to a money laundering offence. If self-laundering was explicitly excluded, it would have been those who assist in the laundering activity that would have been targeted by the law.

The immediate purpose of the accessory's actions, we may assume, would be to help the principal in the money laundering offence to cleanse the assets. Any type of complicity in any type of crime is normally criminalised as an offence. For instance, the financial and tax advisor who assists in the management of the proceeds automatically commits a laundering offence. However, if the laundering offence has been defined so broadly as to include *use* of property, then facilitating the use of the property could mean anything, including the electrician coming into the house of the mafia kingpin to fix the cables (knowingly, with intent).

At first sight this sounds absurd: would any prosecutor submit such a charge? Yes, this may well happen, because it can be used indiscriminately against the whole social environment of an 'organised criminal'. Such a legal trawler net has its predecessors: the US RICO Act and the wire fraud statutes. So the potential absurdity of interpretations, stemming from the broad scope and ambiguity of the definition, will not worry law enforcement. Yes, the electrician, who is important for the safety system around the villa of the gangster can be charged for participating in a criminal organisation in conjunction with money-laundering. Regrettably, in view of the history of prosecutions and convictions, it appears that money laundering is a legal trawl, mainly used successfully for catching just the smallest fry.

141 Although there has been an effort on the part of lawyers and lawyers associations to address issues arising from anti-money laundering legislation, this effort remains inconsistent across countries and has achieved little.

3.2.8. An empirical analysis of the application of the definition

As noted earlier, a laundering charge apparently can fit the frame not only of any act that follows the predicate crime but, under certain circumstances, can be applied to that predicate crime too. It generally targets not so much the intent to provide legitimate appearance to crime money, but any form of crime money management or logistics, or, in other words, any relationship between the (new) illegal owner and the criminally derived advantage.

In case of some forms of (tax) fraud the overlap is so significant that the instrument of fraud is the same as the instrument of laundering. Of course, the concurrence of penal clauses is a normal practice and prosecutors have the freedom to choose what charge to file (*e.g.* at any rate in the Netherlands as long as they select the charge with the highest maximum sentence). So why should the *reflexive* application (self-laundering) of the laundering definition be a problem for practitioners? The fact that it creates arbitrariness, particularly in situations where the maximum punishment for laundering is higher than that for the predicate offence, seems to be of little concern.

This section will seek to assess the degree to which the internationally accepted money-laundering definition (reviewed earlier)[142] is empirically convincing. Its construction will be applied and tested in different predicate crime contexts on the basis of hypothetical and real case studies.

Washing one's own dirty linen or the legal implications of self-laundering

As we have seen, practically in every case of crime for profit the perpetrator can be charged with laundering along with the predicate crime (in those countries where self-laundering is criminalised). Empirical research shows that, indeed, a prevailing number of money laundering cases involve laundering of one's own proceeds or self-laundering (Levi and Reuter, 2006). For instance, every drug trafficker can be put on trial for laundering irrespective of the subsequent ways or success of possessing or managing his crime-money. Based on concepts developed in the USA, the definition aimed from the beginning at a legal trawler-net effect, allowing easy application and no escape. So, what does the 'catch' look like and what about the size of the fish? Research shows that confiscation laws are more successfully applied to criminals of minor importance rather than Mr Bigs (see Vruggink, 2001; Van Duyne, 2002b) who, in the economic crime field, often get away with more lenient sentences, if they are prosecuted in the

142 In a number of countries outside the European Union, regulations similar to the ones within the EU have been adopted following the US approach.

first place. If one reads the press, it seems indeed that the trawl net catches usually a lot of relatively small fish and relatively few cases involve Mr Bigs (one may wonder why). Among those few cases is the Colombian drug kingpin Diego Montoya, one of the FBI's 'ten most wanted', who was captured in September 2007, after over fourteen years of criminal activities. According to press reports, he was to be extradited to the US to face trial on drug trafficking, murder and the inevitable money laundering charges introduced in 2004. However, the majority of cases, where money laundering charges have been raised, involve small-scale offenders and self-laundering.

> *The embezzled cheques*
> For instance, in United States v. Paramo, 998 F.2d 1212, 1218 (3d Cir. 1993), after the defendant had embezzled IRS refund cheques, he cashed them and spent the money on personal items. The court decided that the act of cashing 'promoted' the predicate crime, hence it constituted a laundering offence. As mentioned earlier, in the US this is known as 'promotion money laundering', because converting fraudulently obtained cheques into cash is said to promote the underlying fraud by giving the defendant access to funds. An intent to plow back the proceeds into the scheme was not required here as it was decided that a defendant can engage in financial transactions that promote not only ongoing or future unlawful activity, but also prior unlawful activity. The cheques created a value. If the cheques were not cashed, they would have been worthless. In a way, the argument about contributing to the prosperity of already completed transactions is reversed causality.[143] Paramo received a sentence of forty-six months imprisonment.

Punishing for promotion money laundering is in the spirit of US legislative and sentencing tradition to punish for wire fraud and the use of interstate commerce and communication facilities (*e.g.* mail and telephone) in committing

143 Some courts have considered that 'promoting' entails investing the proceeds in maintaining the scheme in the future (see, for instance, United States v. Singh, 518 F.3d 236, 247-48 (4 5 th Cir. 2008), a prostitute who uses the money received from her first customer of the day to pay for her motel room commits promotion money laundering where the payment gives her the right to the use of the room for the rest of the day without further charge, and creates goodwill for future transactions); there have been also a significant number of cases where proceeds have been spent on personal expenses rather than investing back into the scheme and this has nevertheless been construed as 'promotion money laundering' (as in the case United States v. Paramo; see for comments Cassella, 2009; see also United States v. Skinner, 946 F.2d 176, 177-78 (2d Cir.1991) where a conviction was affirmed of defendant who acquired money orders to pay for prior drug purchases).

crimes.[144] In the above cited case, if the defendant had decided for some reason to get rid of the cheques, he might have escaped the laundering offence. Although, even that is questionable: for a while he possessed the cheques, which is enough for laundering.

By basing their charge on the broad definition of laundering, investigators and prosecutors appear to be less concerned about having to prove the predicate crime. This is particularly relevant in countries where in stand-alone money laundering prosecutions it is not necessary to wait for a conviction for the predicate crime.[145] Then, it may be sufficient for sentencing if the defendant cannot provide a proper justification for the ownership of the proceeds or his unusual handling of it.

It has already been mentioned that the predicate crime may carry a different penalty for different moral culpability. Thus, a criminal may be punished more severely if charged with laundering (see Van Duyne *et al.*, 2005) than if successfully charged with the predicate crime which leaves the gate open for abuse of powers by law enforcement agencies and prosecution.

Investing in gambling business

In United States v. Santos (mentioned previously), Efrain Santos ran an illegal gambling business. His runners took in bets at bars and restaurants, and of that money he kept a cut for himself and the rest was used to pay winning bets, labour costs, and other expenses necessary to maintain his illegal business. For these transactions he was charged under 18 U.S.C. § 1956(a)(1)(A)(i) for 'promotion money laundering'. At first, Santos was found guilty by a jury but the Court of Appeals for the Seventh Circuit reversed the conviction in United States v. Santos, 461 F.3d 886 (7th Cir. 2006). This decision was upheld by the Supreme Court in United States v. Santos, 128 S. Ct. 2020 (2008). Justice Antonin Scalia, on behalf of a four justice plurality, reasoned that the US money laundering statute was ambiguous in that it was not specified whether the term 'proceeds' should mean profits or gross receipts. Applying the rule of lenity, he noted that courts are required to construe ambiguous statutes in the way that is most

144 In the above cited United States v. Skinner, 946 F.2d 176, 177-78 (2d Cir.1991) the defendant was also convicted of several counts of use of the mail and telephone in committing a drug trade related felony.

145 For instance, as previously noted, the Warsaw Convention states that each Party shall ensure that a prior or simultaneous conviction for the predicate offence is not a prerequisite for a conviction for money laundering; and each Party shall ensure that a conviction for money laundering is possible where it is proved that the property, the object of paragraph 1.a or b of article 9, originated from a predicate offence, without it being necessary to establish precisely which offence.

favourable to the defendant in a criminal case. Thus, Justice Scalia concluded, because it would be harder for the Government to satisfy a profits test in a criminal case, 'proceeds' should be taken to mean 'net profits' and not 'gross receipts'. As Cassella (2009) points out, it appears that the plurality in the Supreme Court, similar to the panel in the Seventh Circuit, was concerned that the Government was abusing the statute by charging promotion money laundering, where the transaction was nothing more than a payment of expenses relating to the underlying crime, and using the "*statute to impose a 20-year sentence – the punishment for money laundering – on someone who had done nothing more than commit a gambling offense that carried a maximum penalty of 5 years. In such cases, the plurality said, the money laundering charge merged with the underlying unlawful activity, such that a conviction for money laundering would constitute an improper second conviction for the same offense*" (Cassella, 2009). According to Justice Stevens, allowing the Government to treat the mere payment of the expense of operating an illegal gambling business as a separate offence is tantamount to double jeopardy, and it is particularly unfair in this case because the penalties for money laundering are substantially more severe than those for the underlying crime of running a gambling operation.

And vice versa: a criminal may actually get away with a lighter sentence for the laundering offence, as the following case appears to illustrate.

Mr Big

One of the few Mr Bigs, prosecuted for money laundering, is Terry Adams, described in the press as the Godfather of a London-based criminal clan. After several years of a lengthy trial, in 2007 Adams was convicted of money laundering and jailed for seven years. Adams had managed to previously escape any other charge, although he was believed to have once been heavily involved in drug trade, extortion and other violent crimes. He retired in the late 1980s, at 35, after having allegedly amassed significant wealth. In the following years he enjoyed a lavish lifestyle. Yet he was unable to prove that he had a legitimate source of income. He claimed to earn £200 a week as a marketing consultant and paid minimal tax. The police and prosecutors managed to pin him down after two years of surveillance and forensic tracing of his money. In May 2003 he was arrested and charged with money laundering, tax evasion and handling stolen goods. His wife, Ruth, was charged with similar offences. However, Adams managed to play the game well and delayed the proceedings as much as possible.[146] In the end, he admitted to the laundering charge – conspiring to hide £1 million – but in return, the remaining charges against him and his wife were effectively dropped.

As discussed in the previous section, according to UK and Dutch law in standalone money laundering prosecutions it is not necessary to wait for a conviction for a predicate crime (it would suffice to circumstantially show an association with alleged predicate crimes such as drug trafficking and extortion, in which Adams was believed to have been involved in his earlier years). Thus, Adams was effectively sentenced for self-laundering as this was the easiest charge to prove. As a result, he appears to have received a relatively light sentence: seven years imprisonment (although he could have been jailed for up to 14 years) and a financial penalty which covered only a small fraction of the costs of the investigation and was minor compared to his estimated illicit wealth.[147] A comparison with the Swiss case reviewed earlier (the drug money hidden in the kitchen) could raise questions about law enforcement efficiency and justice.

An interesting question that arises from the Adams case is: if someone spends more than he appears to earn, does this automatically mean that he is laundering money, even though no predicate crime has been proven? What appears to be a reverse burden of proof in a situation like this exposes the danger of undermining basic procedural safeguards of a trial that can lead to abuse of power by the authorities. Or it entails a 'fiscalisation' of the penal process: if one's expenditure level is higher than the stated income and wealth and no explanation can be given for this deficit, there may appear to be proof of income tax fraud /tax evasion as far as it concerns civil law regulatory procedures.[148] But now we have a cross-over to criminal law concerning the same

146 Including, as reported by Kirby, *The Independent* of 8 February 2007, by dismissing his lawyers twice, ordering the transcription of thousands of hours of taped conversations and, amazingly, by once claiming that his IQ was too low to understand his indictment.

147 The press has reported on various estimates of the investigation and prosecution costs. According to a *BBC* report (Summers, *BBC*, 9 March 2007), Judge Pontius made a £750.000 confiscation order against Adams and ordered him to contribute a further £50.000 towards the costs of the £1,7 million prosecution, while his ill-gotten wealth was estimated at £11 million. According to other estimates, prosecution costs amounted to over £4 million. So even if Adams covered all prosecution costs, there would still be investigation costs outstanding. According to various press reports, the estimated costs of the investigation ranged from £ 10 million to £50 million. (Laville, *The Guardian*, 10 March 2007 and 19 May 2007; *The Irish News*, 22 May 2007; Rojas and Raif, *Aberdeen Press & Journal*, 10 March 2007).

148 The standards of proof required in a criminal case are higher than in a civil lawsuit. In English law prosecutors must prove the guilt of a criminal "beyond reasonable doubt" whereas in a civil action the plaintiff has to prove his case "on the balance of probabilities".

facts. Tax fraud is a criminal offence; hence spending or even possessing the criminal tax savings is laundering. If the authorities want to follow this course, one should realise that a substantial portion of the otherwise law-abiding population is guilty of money laundering (yet large-scale and morally questionable tax avoidance by multinationals goes unimpeded as long as it remains just at the very thin blue line). If this is accepted, wielding the stick of money laundering charges may be an effective means to rake in a substantial part of the evaded tax money.

If the authorities do not choose this fiscal path in the criminal world and if no predicate crimes are proven to the criminal standard of proof, why would they not follow the civil recovery path[149] instead of applying criminal procedures? Indeed, in the case of Adams, the defendant was perceived as a big-time gangster and perhaps the penal approach was seen as rather morally more appropriate. For law enforcement authorities and prosecutors, to achieve a criminal laundering conviction appears to be far more impressive than to convict someone of tax evasion (although a laundering charge could easily have been added to the other charges) and /or to use civil recovery procedures.

The good old launderettes

The legend about Al Capone's launderettes is not without basis. Large-scale long-term criminal activities which involve individuals with different responsibilities, or what is commonly perceived as 'organised crime' (whether drug trafficking, human trafficking and smuggling, arms dealing and so on), usually require a legitimate front that would justify the regular inflow of income and serve as a practical pretext for the financial logistics and other organisational matters. Cash-rich businesses are the ideal front, as it is difficult, almost impossible, to establish the precise amounts of money actually coming in and going out (as expenditures). Thus, crime money can easily blend with legitimate income. Major criminals appoint associates to handle the money laundering operations and run front businesses which can range from restaurants and pizzerias to car rental companies, laundrettes and so on. We see a demonstration of this

149 For instance, in the UK (under the Proceeds of Crime Act 2002) law enforcement agencies and prosecutors can pursue a civil recovery procedure to recover, in civil proceedings before the High Court or Court of Session, property (estimated to be at least £10.000, other than cash or negotiable instruments, although cash is recoverable if it is in addition to other property) obtained through unlawful conduct or, in civil proceedings before a magistrates' court, to forfeit property which is intended to be used in unlawful conduct. However, criminal prosecution must have been considered and either expected to fail or proved impossible to complete. Additionally, there must be evidence of criminal conduct that is supported to the civil standard of proof (*i.e.* on the balance of probabilities).

phenomenon in the case uncovered by Operation Dinero, a joint law enforcement operation undertaken in the USA in the early 1990s. The investigation discovered that the Columbian drug trafficking 'cartel' Cali, the Pasquale Locatelli organisation active in France, Romania, Spain, Greece, Italy and Canada, and the Severa criminal organisation in Italy used cash-intensive businesses (for instance Severa laundered money via three supermarkets and a car rental business) for laundering purposes. They also used complex financial networks of shell firms and offshore banks, and other methods including acquisitions of art and antiques (Williams, 1997).

Criminals may also use 'front' businesses that do not actually operate but function only on paper, which is quite usual. The real craft of handling a front firm lies in its ability to operate under the guise of a *bona fide* company. For instance, in the late 1980s US regulators unearthed operation La Mina, which was run by Eduardo Martinez Romero.[150] It involved fictitious jewellery wholesalers and gold bullion businesses laundering cocaine proceeds on behalf of the Medellin Cartel. The laundering operation provided the perfect legitimate appearance for the drug proceeds, except that the choice of an export country turned out to be somewhat ill-advised. The US Department of Commerce discovered that Uruguay had become the second largest exporter of gold to the USA, even though the country had no exploitable gold reserves. Besides, the Well Fargo Bank in Los Angeles reported to the FBI that the Andonian Brothers, the jewellery front firm, were making cash deposits on a much larger scale than usual for jewellery businesses (Williams, 1997). Therefore, if the perpetrator of a criminal act does not pay attention to the 'ceiling' of his 'legitimate' enterprise, he runs the risk of being easily detected when the volume of the turnover goes beyond this reasonable 'ceiling'.

The laundering act in the cases described above falls into the category of the first and second sections of the earlier reviewed international definition, as the primary objective in this operation was concealment of the criminal origin of the proceeds by presenting them as jewellery wholesale revenues. Issuing invoices in cash-rich businesses appears to be the easiest way. Clutterbuck (1995) for instance describes several such cases that took place during the 1980s. In the early 1980s $46 million from heroin traffic landed in a bank account in Switzerland through a scheme involving fictitious fruit export from Sicily to a fictitious juice producing company in London. In another case, in 1985, three brothers were arrested in Palermo for laundering drug profits for *Cosa Nostra*

150 As reported by Labaton, *The New York Times*, 23 August 1989.

through issuing inflated gold and jewellery invoices to a Maltese jeweller. In 1985, in the '*Pizza Connection*' case, it was uncovered that *Cosa Nostra* laundered heroin traffic proceeds through pizza houses and fast food bars bought by New York Italians. In such cases, surveillance and other investigative techniques perhaps help to establish the non-existence of a business. But accountancy control is crucial in comparing observation findings (such as number of actual customers and so on) with figures (turnover, profit and so on).

All these cases can easily fall into the category of the second provision of the money laundering definition: concealment and disguise of the origin of the property (plus movement and transfer of crime property). However, strictly speaking, this is an underestimate because in these schemes criminals tried to achieve more than simply hide their money or conceal the origin of it. They also fabricated an appearance of legitimate origin of the property. These schemes took place when the anti-money laundering war was in its early years of development and the legal concept of money laundering was relatively new. However, criminals already knew how they should best manage their money and had their own idea of money laundering. As these schemes suggest, criminals tried to justify the existence of their crime money (or its movements) in order to be able to freely enjoy it. This was money laundering in the strictest 'classic' sense.

Washing with no detergent or the 'hereditary' chain of laundering actions

If the owner of a restaurant business with no apparent economic viability, or a casino that is empty most of the time, regularly pays income tax, it would not be far-fetched to think that they must be laundering ill-gotten gains through fictitious sales. But how can we best qualify the following situation: a restaurant business boomed after the investment of drug money as a one-off financial injection. This investment was not intended to provide a justification for the crime proceeds, but to give a boost to the business and earn more money through a successfully and legally run restaurant. Nevertheless, this first investment easily qualifies as money laundering under the third provision of the international definition: *acquisition*, *possession* or *use* of criminal proceeds with knowledge as to the origin of the money. But there is more to it: the question is whether the 'post-laundry' profits from the licit restaurant exploitation, duly recorded and taxed, are also the 'fruits of crime'. The application of the laundering definition is so broad that it creates "*a long 'hereditary' chain of laundering actions with many accessories*" (Van Duyne *et al.*, 2005, p. 22). As a result, anyone knowingly involved in the management of the original investment and the subsequent profits can potentially be charged with laundering. If laundering occurs each time a legitimate profit is generated, even though crime-money has been invested just once, then the question can be extended to the situation where reputable western banks buy allegedly tainted assets. We observe links in a long 'hereditary' chain of actions starting with an initial laundering act. But where does the chain end?

Often this is the situation with investments in emerging markets. If an international banking institution buys a share in a small bank in Russia or Central and Eastern Europe that had been alleged to be involved in questionable dealings, that international institution could face, *inter alia*, reputational risks. Yet it would hardly be prosecuted for laundering. However, this appears to be political choice rather than a legal decision, unless a coherent answer is given to the hereditary chain question. For the descendants of alleged criminals knowingly inheriting tainted assets the answer to this question does not appear too difficult: they are at risk of not escaping prosecution for laundering.[151] As we can see, the application of the money laundering definition lacks a systematic and well-grounded approach. It has led to numerous interpretations, most of them not very clear, a situation which produces arbitrary results. This leads to the question: where is *lex certis*? As Van Duyne (2002b) points out, we face a problem of indeterminability or lack of *lex certis* as anything can be labelled as laundering and it is not clear where the application of laundering ends. As a result, the laundering definition can be open to all kinds of absurd interpretations. Of course, absurd from the perspective of legal rights, but not for the prosecution service, as noted earlier.

The range of actions that constitute laundering, even though they are not aimed at laundering in the strict ('white-wash') sense of the term (and therefore can be described as 'washing with no detergent'), is endless. In the Swiss case mentioned previously, ('drug money hidden in the kitchen') the action of the defendant, *i.e.* letting his friend hide the money, was hardly aimed at providing a justification for the illicitly earned money. Yet for simply keeping his friends' drug money and using some of it, the defendant was sentenced by the Cantonal Higher Court of Bern to 20 months imprisonment on charges of *repeated* money laundering. This case falls into the category of the third and also fourth

151 In the Netherlands the guardian of two minors has been prosecuted for accepting the heritage of their diseased criminal father who left a fortune after having received social security benefits for decades (see court case HR 05-09-2006 LJN: AU6712).

provision of the definition: abetting and facilitation of the concealment of the location of the proceeds.

In another similar case, in the USA, August 2006, Lenore Henderson of Matteson was charged with money laundering and pleaded guilty to using $10.000 drug money to post bail for a suspected drug dealer, Anthony Robinson.[152] Again, the offender was in *possession* and *used* crime property.

As remarked before, even spending crime money on daily needs can qualify as money laundering as it is *possession* and *use* of crime property. Of course, 'daily needs' can be interpreted variously, like going on holidays or buying a car, which are considered, for instance in the Netherlands, a manifestation of laundering. Yet this is nothing like laundering in the strict sense of the term, so it is rather washing, but with no detergent.

As previously noted, a well known penal law position is the concurrence of charges. If someone has knowingly bought stolen goods, he can be charged on two counts: handling stolen goods and money laundering. The latter, because the buyer of the stolen goods has come to *possess* and *use* criminal property (as Pieth (1999) points out, in some countries money laundering is perceived as the expansion of the typical act of handling but without the focus on stolen goods). Here we have the same act, yet two different possible counts carrying different punishments. It is not uncommon, of course, that specific behaviour is covered by more than one penal clause. The prosecutor can choose but in most systems he will charge under the article that attracts the highest sentence.

The question is: how helpful is such a major legal overlap, when handling stolen goods is not quite the same conduct as laundering in the strict sense of the term. As in most legal systems, this strict meaning has evaporated, but this may not be a real problem for prosecution or sentencing: handling proceeds, whether whitened or still black, can be prosecuted on both counts. To make things even more complicated, the handling of stolen goods can itself be a predicate crime and anything that follows can be construed as laundering. In short, we have a hereditary chain of *fencing* or *laundering* actions, as previously discussed.

As reviewed earlier, the *acquisition*, *possession* and *use* provision is ambiguous and it is unclear whether it distinguishes between the predicate perpetrator and the person who *receives* the property, *i.e.* it includes self-laundering (unless self-laundering is explicitly excluded). If the thief changes some of the features of the stolen object to disguise its origin, under the *reflexive* application that would

152 See report by Main, *The Chicago Sun-Times*, 20 October 2006.

count as (self-)laundering. Is there a laundering offence where the criminal has no intention to hide the origin or the location of the stolen property and exhibits it publicly but nobody questions him about its origin? If someone has stolen a Picasso painting, and has hung it in his dining room, where every visitor can see it, there still may be a laundering offence. The thief is in *possession* of the painting. He *uses* it, even if the intent to launder in the strict sense of the term is absent.

If someone steals goods but eventually decides that the stolen goods are of no use to him, then these goods are no longer proceeds to him personally. Yet for the legislator (and the Court) these goods still constitute proceeds from crime. For the legislator and law enforcement authorities it would be of no relevance whether the criminal believed that the jewellery he had stolen was valued at €50.000 but in fact turned out to be fake and cost less than €1.000. The criminal would still be in possession of criminal property; hence he would be laundering it. If the criminal had stolen shares which he believed cost millions but they proved to be worthless because the issuing company had been declared bankrupt, then these shares would no longer present an economic advantage to the criminal. Yet again, technically, possessing shares without any value could still be construed as money laundering (the Dutch legal system, for instance, takes no account of changes in the value of the property). A thief might regard the computer he had stolen as nothing more but a pile of cables and bolts, if it turned out he was unable to sell it. Yet again, as above discussed, technically by definition the computer would still constitute proceeds, even if it is not considered as such by the criminal himself and it has no commercial value. We see an attempt in the Second and Third EU Directives (Directive 2001/97/EC and Directive 2005/60/EC), to limit the uncertainty of such interpretations. It is noted that the property subject to laundering has to be derived from criminal activity that constitutes a 'serious crime' (the definition of which was reviewed earlier). However, even with this clarification the clause remains broad. The theft of securities or computers, even if they turn out to be of no commercial value, can constitute a serious crime as long as the maximum punishment is at, or over, the threshold stipulated by the relevant directive. As there are practically no or few property crimes with punishments below this threshold, this would enable prosecutors to describe as money laundering all acts subsequent to the property crime, or the act of theft in particular.[153]

153 The chain of laundering actions can be endless. The sale of stolen goods, regardless of the value, can constitute laundering. The sale of these proceeds produces further proceeds. Whatever is done with the latter, will likely be laundering too. If the thief sold the stolen painting to a col-

What is of value to the offender at one point may no longer be of value if the offender's circumstances change. This raises the question about 'economic advantage'. For example, would a businessman who may have corruptly benefitted from preferential treatment ('economic advantage') in a tender situation but in the end decided to withdraw from the tender, still be accountable for money laundering? Presumably not, after a voluntary withdrawal. However, the fact that he has withdrawn from the tender does not exonerate him but the question is whether a money laundering charge, albeit perhaps technically applicable, would be the most adequate to raise. As it appears, potential charges which years ago would have been considered "far-fetched" or even inadequate are being filed nowadays as quite normal (as demonstrated in this thesis, see below). Jurisprudence develops and one should take into account that criminal clauses tend to develop a "wall-to-wall" coverage. For example, if it has been determined that any handling of loot after a crime-for profit is laundering, the attempt to commit a crime-for-profit should also be considered as an attempt to launder.

In the same line of thoughts, how adequate is it to apply the money laundering definition with regard to those who just happen to use a property derived from crime by someone else? As previously discussed, the Strasbourg Convention suggests that legislators may envisage the possibility for laundering charges in the case of negligence. This is a common legislative practice: many penal clauses have the 'ought to have known' component. It also applies to receiving stolen goods: 'knowing or should have known' and has been applied to housewives receiving household money from their husbands fiddling their social security. Under anti-money laundering laws they can be prosecuted for laundering. This further expands the reach of the anti-money laundering regime. The mistress of a Mafia kingpin risks laundering charges if she accepts any benefits, whether money, gifts, holiday trips and so on, from her lover, because she ought to suspect that her lover's money is tainted and therefore she should not be accepting it. The same applies to anyone from relatives to charity organisations. Of course, there are concurrent clauses. As previously noted, the

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lector, whatever he would do with the profit would constitute laundering. The buyer of the painting could also be charged with laundering, if he knew (or should have known) that the painting had been stolen. As remarked previously, even lying about the painting, claiming it was a duplicate, could theoretically be construed as laundering. If police informants knew about the theft and the whereabouts of the painting but lied about it, they would be helping the thief to conceal and possess the painting. As in the case of handling stolen goods, here we would have one act but two possible counts: perverting the course of justice or laundering (although, again, the observed conduct would not be quite the same as laundering in the strict sense of the term).

prosecutor is allowed to choose, and he will see no problem with that because the logic is that no one should be benefiting from crime money. In the prosecutors' view, this apparently also applies to defence lawyers, and certainly suspected criminals should be prevented from hiring good lawyers, as the following case demonstrates:

Vetting the source of fees for defence lawyers

In 2008 prominent Miami lawyer Benedict Kuehne, known for representing Vice President Al Gore in the 2000 Florida vote recount, and for pro-bono work advocating civil rights in the courtroom, became the target of media attention in relation to a money laundering trial. According to the media, some of Kuehne's supporters have suggested that his prosecution could be politically motivated.[154] An indictment unsealed 7 February 2008 states that Kuehne was charged with one count of money laundering conspiracy, four counts of money laundering concealment and one count of obstruction of justice.[155]

The indictment further states that in 2001 Fabio Ochoa, leader of Colombian cartel Medellin was extradited to the US to be tried on drug trafficking charges. In 2002 Ochoa's Miami-based criminal defence team hired Kuehne to vet the source of approximately $5,2 million,[156] which Ochoa would use to pay the legal fees, and to certify that the funds were not the proceeds of, or commingled with proceeds of, Ochoa's drug trafficking business.[157] Between April 2002 and September 2003 Kuehne drafted six opinion letters stating that the funds were from legitimate sources, including transfers from Hernando Saravia who Kuehne had established was a *bona fide* businessman. In the vetting process Kuehne was assisted by his Colombian co-defendants – Ochoa's cousin, attorney Oscar Saldarriaga, and Ochoa's accountant, Gloria Florez. Prosecutors alleged that the defendants prepared fraudulent documents (including spreadsheets and receipts) to support Kuehne's false assertions, and in some transactions commingled drug proceeds, through the Black Market Peso Exchange. The indictment further states that part of the funds which Kuehne attributed to Hernando Saravia in fact

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154 Pacenti, *Daily Business Review*, 2008.

155 The indictment was originally issued in 2005 but remained dormant until Kuehne was added to the sealed case in October 2007. See for details Unites States of America v. Gloria Florez Velez, Benedict P. Kuehne and Oscar Saldarriaga Ochoa, Case No. 05-20770-Cr-Cooke(s), filed with the United States District Court Southern District of Florida.

156 The author has used in this thesis Arabic numerals (European connotation) with decimal comma (*e.g.* one million British pounds and 80 pence would be 1.000.000,80).

157 For his services Kuehne was paid $197.300.

came from undercover US law enforcement operations and constituted drug trafficking proceeds. Whether Kuehne's engagement in the vetting was due to naivety, negligence or was in fact a savvy legal manoeuvre on his part is unclear. But apparently Kuehne was not aware that Saravia was facing federal drug money laundering charges in New York and was cooperating with federal prosecutors. According to media reports, Ochoa had first hired attorney Jose Quinon, but the latter withdrew over concerns about Ochoa's ability to pay with clean funds. As a result, Ochoa hired defence attorney Roy Black who in turn retained Kuehne to vet the fees for him, "*setting up a buffer for any legal jeopardy*".[158] Kuehne's lawyers argued that the money laundering conspiracy charge against him violated the 1988 US Constitution's Sixth Amendment guarantee that a person charged with a crime has a right to a lawyer. In December 2008 US District Judge Marcia Cooke agreed with that argument and rejected the US Justice Department's contention that the payments for the legal fees were not necessary for Ochoa's defence. Thus, the judge dismissed the central charge in the case.[159]

Reportedly Kuehne's prosecutors argued that attorneys are not immune from prosecution for money laundering simply on the basis that they represent criminal defendants.[160] However, it is unclear on what evidence prosecutors based their case against Kuehne if he was merely providing legal advice and appears to have genuinely believed that part of the money was coming from a legitimate business run by Saravia. But Kuehne's situation is tricky. He assisted in providing legitimate appearance to the funds, whether or not he believed that the money was clean is unclear. The wider question is: even if Kuehne was not naïve and was aware of the true origin of the funds, should that mean that Kuehne and Roy Black, similar to Jose Quinon, should have refused to take the case on? If Kuehne had not vetted the funds and provided his opinion, Ochoa would have had difficulty hiring a lawyer to defend himself. As previously mentioned, one could argue that drug barons should not be able to hire private and expensive lawyers. However, the same should apply to a range of other crimes, including tax evasion and corruption. As representatives of the National Association of Criminal Defense Lawyers argued, prosecuting defence attorneys could deter lawyers from representing clients in cases where there might be a reason to believe that the source of the funds for paying the legal

158 Anderson, *Associated Press*, 23 March 2008.

159 The money laundering conspiracy charge was apparently easier to prove than the money laundering concealment charge.

160 Anderson, *Associatd Press*, 23 March 2008.

fees might be questionable.[161] Furthermore, the fact that a lawyer who was providing advice to another defence attorney was charged with money laundering means that there are no boundaries for prosecutors to raise such charges against anyone. So while trying to catch the bad guys, are we not creating another danger: the danger of undermining the basic principles of law which safeguard against abuse by those who have powers?

It is clear that the laundering clause can be used to fill in many prosecution gaps, even where there are other, perfectly defined, relevant penal clauses (handling stolen goods or fencing, perverting the course of justice and so on), and is applied as a panacea against all kinds of evil as the following case demonstrates:

> *Harbouring illegal aliens*
> In 2006 Xiang Hui Ye and Xian Xi Ye, owners of Buffet City restaurant in Springfield, in the US state of Illinois, were indicted for harbouring and employing illegal aliens at their restaurant. The indictment alleged that from January 2005 through September 2006, they knowingly provided employment, housing and transportation to illegal aliens for commercial advantage and financial gain. Xian Xi Ye also admitted he had signed checks (derived from this illegal employment) to pay for apartments that were used to house illegal aliens, and therefore he was also charged with money laundering. The statutory penalty for the felony offence of harbouring an illegal alien is up to 10 years; the penalty for the misdemeanour offence of hiring or recruiting illegal aliens for employment is up to six months in prison and a fine of $3.000 for each illegal alien; while the laundering charge may lead to a penalty of up to 20 years in prison. In September 2007 Xian Xi Ye pled guilty to harbouring illegal aliens and money laundering. In January 2008 he was sentenced to 18 months in prison (but was reported to also face deportation) and was fined $2.500. [162]

As we see in this case, because the defendant *used* crime money to pay for the rent, prosecutors have decided that he could be charged with laundering (in the spirit of 'promotion money laundering'), regardless of whether harbouring and employing illegal aliens was the actual crime, while the rest was just inevitable logistics such as procuring food or paying for one's own accommodation.

161 Anderson, *Associated Press*, 23 December 2008.
162 See media reports, including *US Fed News*, 5 October 2006; Antonacci, *The State Journal-Register*, 5 September 2007; Antonacci, *The State Journal-Register*, 13 October 2007; *Northwest Herald*, 29 January 2008; *Associated Press*, 1 February 2008, see also USA v. Ye *et al*.

The two-wash centrifugation cycle

The previous sections elaborated already the point that the laundering definition is so broad that it overlaps not only with the offence of handling stolen goods but also with a number of other crimes, specifically fraud and forgery. However, while in the case of handling stolen goods, the observed predicate conduct is not quite the same as the subsequent laundering in whatever meaning of the term, in the case of fraud, especially tax fraud, the observed conducts can be very similar. In fact, the observed conducts can coincide, fully or partially (see Van Duyne, 2002b). Palmer (2001, p. 6) notes that "*[f]raud is **not** money laundering. Reinvesting the proceeds of fraud is. [. . . but] the definition of fraud has either been ignored or we have not accepted that the definitions of fraud and money laundering have blurred into one and the same.*" Indeed, the laundering definition has been broadened to such an extent that it easily overlaps with fraud, even where the purpose of the fraud is not laundering in the strict sense. Where fraud is used to launder, the overlap is obvious. Thus, fraud can be both a predicate crime, and consequential to the predicate offence. In the latter case the fraud is committed to launder and therefore both qualifications can be applied.

Fraud *and* laundering can be subsequent to a more common property crime. If a thief claims that he has legally purchased the painting that he had in fact stolen, and produces a false evidence of purchase, he commits documentary fraud. But this can also qualify as laundering: the prosecutor can choose on which point to charge (if both offences have the same maximum penalty).

In the context of tax fraud, money laundering most often overlaps with the predicate crime. By committing, for instance, VAT fraud, the offender concurrently commits a laundering offence as with the same fraudulent documents he instantly produces crime money that looks clean. Figuratively this can be described as "*canned laundering*" (Van Duyne, 2003b, p. 72) and once again we see the effects of a *reflexive* application of the laundering term. All classical tax fraud schemes simultaneously constitute a predicate crime and money laundering. For instance, if in the case of importation into Bulgaria of materials that are to be processed, no VAT would be due, these 'materials' could be subsequently channelled through a number of intermediary companies, each of which would be paying VAT. Afterwards the 'processed' materials could be fictitiously exported. The VAT, accumulated over the whole chain of intermediaries, would be due to be returned from the state budget as export is exempt from VAT. As soon as the tax authorities return the accumulated VAT, they recognise the legality of the transactions. This would mean that the proceeds from the tax fraud scam would be successfully laundered. In such cases prosecutors can raise both fraud and laundering charges. As reported by the press and various case-digest journals in the past few years, particularly in the USA, prosecutors seem to have been quite successful in bringing up money (self-) laundering charges alongside the charges for the predicate offence of fraud.

The timeshare scam reportedly masterminded by the infamous British businessman John Palmer, also known as Goldfinger, is another example of a predicate crime that technically also constituted a laundering offence:

> *The timeshare business of Palmer*
>
> John Palmer started his timeshare business in the mid-1980s, when he flew from Britain to Tenerife for a holiday. Later the police would discover that Palmer and his accomplices had used high-pressure sales techniques to trick tourists into the scam, and established a network of 'independent' firms to run the business. In May 2001 Palmer was sentenced[163] to eight years for conspiracy to defraud, although he could have potentially been convicted of self-laundering too but such charges, it seems, were never raised. He was also issued with a confiscation order for £33 million of his reputed £270 million assets and was ordered to pay another £2,7 million in compensation to his victims. As reported by the *BBC* on 23 April 2002, this was the biggest confiscation order in English legal history. Defended by lawyer Giovanni di Stefano, the Devil's Advocate, as he became widely known, within a year Palmer managed to overturn the confiscation order. Lord Woolf, the Lord Chief Justice, commented that Palmer should have had his money confiscated but ruled that an earlier appeal court decision that allowed him to hold onto his assets could not be overturned.[164] Not only did Palmer keep most of his money but he also served just about half of his term. Soon after he was released from prison, however, he was arrested again, this time in Spain. In July 2007 the press reported that Palmer was taken by the Spanish police at the airport in Tenerife as he was wanted by the court on suspicion of leading an international criminal group. He was reported to have faced charges that this time included also money laundering,[165] *inter alia*.[166]

163 After a five-year police investigation, in 1999 Palmer was brought to trial in the UK. His 2001 sentence was the result of lengthy procedures and a third retrial at the Old Bailey.

164 See *BBC* report of 23 May 2003.

165 Ironically, about twenty years earlier Palmer was nearly convicted of handling about 6.800 ingots of stolen gold, an act that would have nowadays equalled to laundering. Palmer had earned his nickname, 'Goldfinger', after allegedly smelting down much of the gold that had been stolen by others in what became known as the £26 million Brink's-Mat robbery near Heathrow airport in 1983 (money laundering was first criminalised in the UK in 1986 with the

In the autumn of 2009 the media reported that after being held in a Madrid prison for two years while a police investigation was taking place, Palmer was released on bail and was now believed to be living on his £6 million yacht The Brave Goose Of Essex.

Apparently after Palmer appeared to have escaped major punitive justice in Britain, Spanish prosecutors decided to resort to the easier and far-reaching laundering clause that can plug every hole.

It goes without saying that the fight against crime is not easy and legal devices that can plug any hole can be a good thing if balanced against other legal principles. However, as noted earlier, it appears that the laundering charge is primarily used to catch small fry and apply a higher penalty than for the actual predicate crime. In the very rare cases of catching bigger fish, although the maximum penalty for laundering in the USA is 20 years, savvy lawyers can use to their advantage the loose money laundering definition and help villains walk away with lenient sentences because no better clauses have been applied.

Laundering an unconventional load

As discussed earlier, anything can be proceeds of crime, *i.e.* object of laundering. We usually think of laundering in financial terms, associating it with either money, liquid or highly valuable assets such as precious stones or artwork. But there are instances, where although unconventional – because of the object of laundering – the application of the term is quite appropriate as it matches the strict meaning of it, *i.e.* ensuring legitimate appearance of the crime property.

For instance, in February 2007 Greenpeace released a report (Van de Water and Schuiling, 2007) which claimed that in 2006 Dutch harbours facilitated the laundering of illegally caught fish from the Barents Sea by allowing 'pirates' to offload their catch and enter the market unchecked. It was noted that Dutch inspection authorities only measured the quantity of fish but carried out no verification checks with regard to the legality of the catch (at least this was the case as of the time of the report). A catch that simply goes unchecked is not yet laundered in the strict sense of the term (although, as soon as it is accepted in a Dutch shop or in the marketplace of another country, it is likely that the fish

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Drug Trafficking Offences Act). Although Palmer had allegedly admitted smelting the gold in the garden of his mansion in Bath, he denied knowing where it came from. As the police had failed to prove that he had knowingly dealt in stolen property, Palmer was allowed to walk free from the trial in 1987. He famously blew kisses to the jury on his way out of the courtroom.

166 The case was widely covered by the press (see Vasagar and Hopkins, *The Guardian*, 24 May 2001; Tremlett, *The Guardian*, 13 July 2007).

will be automatically perceived as legally caught). However, if at any point of the supply chain an inspection is carried out, the crime may get discovered. Therefore, pirate vessels 'launder' the catch. A report by the Environmental Justice Foundation (2007) concerning pirate fish sold in the UK marketplace described the range of practices that pirate vessels sometimes employ to ultimately present their catch as legally caught. Referring to these practices the report used precisely the term 'laundering'. These practices include the illegal trans-shipping of fish between vessels, the repacking of fish products into boxes stamped with the name of a legal boat and more than one vessel purporting to be a single ship. The report highlights that for this reason it is difficult to prove that the fish within the boxes is 'IUU-caught' (IUU meaning illegal, unreported and unregulated).

In 2006 Greenpeace (Stark and Cheung, Greenpeace, 2006) released a report with similar claims but concerning another unconventional object of laundering. The report claims that China played an important role in laundering illegal timber. Becoming the world's 'factory' for plywood, furniture and paper, China imports wood, much of which is illegal, and exports it as 'laundered' wood products. These 'Made-in-China' products are subsequently bought by consumers in the USA, Europe and Japan, who are tempted by the low prices.[167]

As reviewed above, the ambiguity of the money laundering definition allows it to be applied in a wide variety of ways including such can lead to arbitrary results and uncertainties.

3.3. Money laundering – a threat to society?

Is money laundering really a threat to society? This chapter will discuss the moral and socio-economic effects of crime money, of its influx into the licit economy and its laundering, especially in the context of globalisation, with different historical developments in different countries. We will also review whether the difference between the various nuances of 'grey and black taint' of criminal proceeds matters.

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167 Ironically Greenpeace has also been accused of engaging in laundering, except that it is not clear what it had laundered. In 2003 Public Interest Watch, a Washington-based group, which monitors non-profit charity agencies, posted an article by Miller (Miller, 2003) which reported on allegations that Greenpeace illegally spent \$24 million in tax-deductible contributions on banned activities, such as trying to block military ships, by transferring money between different accounts. According to California Assemblyman Ray Haynes, these transactions amounted to money laundering.

3.3.1. The effects of crime money and money laundering

Policy makers' argumentation

What makes money laundering an unusual offence is that it always exists in the context of some other crime (even if in some jurisdictions, a conviction for this crime is not a prerequisite for a money laundering conviction). Money laundering is always necessitated by and is a consequence of the so-called predicate crime for profit. However, policy makers have restlessly sought to demonstrate the existence of the opposite causal or motivational effect and convince the public that if criminals could no longer launder their money and enjoy it, they would feel less motivated to commit crime for profit. In order to justify the robust anti-money laundering regime, policy makers left no stone unturned. Their arguments – some of which are well founded, others appear to be mere rhetoric – range from moral statements to assertions about the social and economic threats that crime money and money laundering pose. Researchers at the Utrecht School of Economics have identified 25 empirical effects of money laundering (Unger *et al.*, 2006) but some of these largely overlap and can therefore be reduced to a smaller number. Available analysis of the effects of crime money and money laundering, however, remains non-systematic and largely conditional due to the relativity of the different concepts (both economic and legal) that are applied and the lack of clear definitional basis. As the concept of laundering is so broad, that it covers any use of crime money, it has hardly a discriminatory and therefore explanatory value as far as its effects are concerned.

- Firstly, it does not distinguish between the effects of crime money in its own right, the effects of laundered money (which still constitutes crime money) and the effects of crime money's laundering.
- Secondly, it also fails to differentiate the effects of laundering from the effects of the predicate crime, when the latter largely overlaps with the former.
- And thirdly, it fails to differentiate it from the black economy, encompassing all hidden money generated, including 'usual' tax evasion.

Nevertheless, policy makers have not stopped reiterating the same arguments over and over again, supporting them with appropriate "*threat imagery*" (Van Duyne *et al.*, 2005; Van Duyne, 2010, p. 356) but with little methodical substantiation. In the following sections the arguments supporting these perceived threats will be elaborated.

Categories of effects

a. The corruption of the financial system: the 'integrity dogma'

Policy makers' central argument has always been that crime money and money laundering corrupt or contaminate (see Unger *et al.*, 2006) the financial system. Therefore, we should use every possible means to prevent crime money from entering the licit economy.

This statement has two main aspects, although not always recognised as different. The first aspect entails material changes in the financial system. According to McDowell and Novis (2001), the integrity of financial markets is undermined when financial institutions rely on crime proceeds and therefore run into difficulties in managing their assets, liabilities, and operations. This argument refers to the effects on the financial system, as part of the economy, and will therefore be reviewed in more detail in the section on socio-economic effects below.

The second aspect, which reflects the more common understanding of this argument, refers to corrupting the integrity of the financial system in the moral sense, *i.e.* lowering the ethical standards within the financial system. The idea that when channelled into the financial system crime money would corrupt it and then spread this corrosive effect throughout the world through usage of global transmission facilities, is widely supported and often quoted as justification for rigid anti-money laundering measures. However, it remains unclear what its causal connection is supposed to be. It is as if crime money *per se* is infectious and carries a disease. And it may well be that this disease is corruption. Crime money can indeed be used to corrupt individual bankers and financiers and influence decision-making processes in business ("*corruptive permeation*", see Van Duyne, 2003b, p. 76; see also Palmer, 2001). However, it appears that policy makers' arguments are not aimed at that act of bribery. They do not say that bribery contaminates the financial system. They say that the results of the *act* of laundering contaminate it: the undetected (or detected but ignored) inflow of crime-money into the financial system. In this context laundering is understood to be the use of the financial system by criminals and the subsequent influx of crime money into the veins of the financial system.

This immediately raises the question: why is this any different to the effect of 'dirty' money that is already inside the financial system as a consequence, for instance, of VAT fraud or simple income tax fraud? Besides, if we equal the mere flowing of crime money through the legitimate system of the economy to the act of laundering, then crime-money should have the same contagious effect on all facilities that play part in money transmission, including the internet. Crime-money flows through the internet all the time but to talk about the undermined integrity of the internet would require a lengthy metaphysical explanation.[168]

The moral argument about integrity, supported with alarming figures on crime money, has an "*emotive appeal*" that conveys controversial images of "*sickness problems*" which are not necessarily actually observed (Van Duyne *et al.*, 2005, pp. 123-124). The argument about the integrity of the financial system could otherwise have been a strong message, if it was not undermined by the vague concept of laundering and its limited focus on the financial system. From this perspective the corruptive effects have also been underlined by stating that by allowing crime-money into the financial system, bankers would become –unwillingly and unknowingly– accomplices to crime or at least facilitating its commission. That may be true, but for the implication that this statement has also no boundaries: it applies to any sector of our economy in which lawbreakers live and spend their proceeds. Policy makers centre their argument on the financial system but implicitly they unwittingly call for an assessment of the corruptness of every single component of our life, not just the financial system. The latter cannot be separated from connected spheres: the economy in general, business, culture, and, most importantly, politics. It is true that scrutiny has been extended to some spheres outside the financial sector such as the legal profession (see Kuehne's case discussed previously). However, scrutiny over donations for political campaigns has not even been anywhere near as rigid as scrutiny over the financial services sector. Therefore, this appeal looses it distinctive value, no matter how lofty it is in a general moral sense.

Although the moral appeal should be universal, its application by policy makers (usually of the G-7[169]) appears to cross the line of political hypocrisy and the use of double standards. While some countries are being internationally targeted for their weak control systems, deficiencies (according to policy mak-

168 That said, the concept of the internet being contaminated and used as a facility to spread harmful content is not new. In 2006 the media reported that Jeffrey Toback, a Nassau County legislator, filed but later dropped a federal lawsuit that accused Google of profiting from child pornography by allowing operators to advertise child pornography websites through sponsored links (Toy, *The New York Times*, 2 July 2006). In 2009 the Chinese authorities accused Google of spreading obscene content (see *Daily Mail*, 27 June 2009).

169 Although G-8 was formed in 1997 with the inclusion of Russia, and then G-20 in 1999, international regulatory and law enforcement policies have largely remained under the influence of the countries of the G-7 group, most notably the USA. This can particularly be seen in the area of policies relating to money laundering, insider trading and corruption of foreign officials.

ers' standards) in the regime of others (more powerful) appear to be condoned (this matter was discussed earlier in this thesis, see section 3.1.6).

Michel Camdessus[170] (1998[171]) highlights that:

> "*Markets and even smaller economies can be corrupted and destabilised. We have seen evidence of this in countries and regions which have harbored large-scale criminal organisations. In the beginning, good and bad monies intermingle, and the country or region appears to prosper, but in the end Gresham's law operates, and there is a tremendous risk that only the corrupt financiers remain.*"

This is a strong appeal indeed, although it appears to be substantiated with little evidence. Its validity appears to be undermined by the economic record of small economies such as Luxembourg, Liechtenstein or (relatively small) Switzerland. As any tax haven, these countries presumably also harbour money from tax evasion, and, possibly, from far more serious offences. Yet these countries do not appear to have considerably suffered from such inflows of money. Whereas poor and politically unstable countries, torn by civil wars, malgovernance and corruption, such as Sierra Leone, are said to have tremendously suffered from the accumulation of crime capital (for analysis of the war-profiteering in Sierra Leone see Smillie *et al.*, 2000). As a matter of fact, there is hardly any significant crime-money accumulation in such countries as illegal wealth is often shifted to more stable jurisdictions. The owners of illegal wealth do the same as the owners of licit funds: money of any colour eschews instability.

Indeed crime money empowers criminals and corruptible politicians. Criminal ambitions grow as the criminal's wealth grows and the best way for criminals to expand their business, whether legitimate or not, is to forge relationships with people of power and administrative leverage. Our lives nowadays are shaped by the principles of the market economy and everybody knows the value of money and how much influence money can buy (Daeubler-Gmelin, 1994). However, the argument about causality, *i.e.* that money laundering and crime money lead to corruption can be reversed in two ways: firstly, corruption within the system and, more generally, the corruptibility of man, precede the money laundering corruption. Actually, the latter is to an extent irrelevant to the really smart launderer whose skill is essentially to manage to

[170] Managing Director of the International Monetary Fund from January 1987 to February 2000.

[171] The quote starts with the fourth sentence of the first paragraph after heading "Macroeconomic impact of money laundering" (no page number available as the article was retrieved from the internet).

stay low-key and unnoticed without the need to corrupt anyone.[172] Secondly, media reports on investigations and existing records of litigation (especially under the US Foreign Corrupt Practices Act) provide evidence of corruption that has been caused and enhanced by perfectly legitimately earned money of reputable international corporations rather than the money of outright criminals (which is a rather ironic observation). In Europe, in all the major corruption scandals of the past decades *white* money was involved.[173]

The reality is that crime money enters the licit economy whether we want it or not. As Van Duyne *et al.* (2003, p. 29) points out, "*[t]he treasury is the 'national pump' of all richness, criminal and legitimate alike*" and it may easily end up handling its own, previously stolen, moneys without recognising it as criminal.

How should financial institutions cope with the mixture of legal and illegal funds? For instance, during the 1990s, in the course of privatisation in Central and Eastern Europe and the former Soviet Union illicit or questionable proceeds mixed up with legitimate earnings like in 'a melting pot' (Hignett, 2005). The system showed (and in fact, regrettably, continued to show well into the new century) strong elements of crony capitalism, where land, hotels, large and lucrative enterprises, public procurement contracts, licences and permissions for various sorts of business activities were distributed between a limited number of people. In many of those countries wealth has undergone a process of economic and financial consolidation. What can we say about the colour of this money? Is wealth that was accumulated in those years still tainted? (The 'heritage' question discussed previously.) How are the financial institutions supposed to treat wealthy customers who at some point have been alleged involved in questionable dealings?

Policy makers and law enforcement authorities send mixed signals on this matter. A number of prominent businessmen linked to allegations of involvement in illegal activities in Russia now live in the UK or the US where they appear to feel quite comfortable. How should financial institutions treat their

172 Why should the criminal want to corrupt the financial system? He is just as interested in having his money handled correctly and efficiently as any legitimate market player. Moreover: corruption involves spreading information, which always carries a risk of exposure.

173 Including the allegations concerning the Augusta-Dassault deal in Belgium; Germany's former Chancellor Helmut Kohl and the French oil company Elf Aquitaine; the cash for honours scandal in the UK; the construction industry scandal and the Rotterdam harbour case in the Netherlands. The amount of white money involved exceeds anything a drug dealer might have dreamt of. One of the exceptions from this list of 'white' money corruption scandals was the allegation that Forza Italia, the political party led by Silvio Berlusconi (which merged into the People of Freedom party in 2009) was financed at some point by the Italian Mafia (see report by Willan, *The Guardian*, 8 January 2003; see also Stille, 2006).

money? Or do we expect estate agents or solicitors engaged in property transactions in West London on behalf of wealthy tycoons from Russia or other emerging markets to submit suspicious activity reports? Another Russian former oligarch, Mikhail Khodorkovsky, who stood trial in Russia for tax evasion and was sent to prison, appears to have been hailed somewhat as a hero-figure by some Western media.[174] One of Italy's most (in)famous politicians and entrepreneurs, Silvio Berlusconi, has attracted considerable attention in the press in relation to allegations of involvement in questionable dealings but that does not mean that many banks (if not all banks) would treat his money as tainted. His money appears to be welcome everywhere. And if it is tainted, it rather demonstrates that the argument about 'crime-money corrupting the financial system' has in its application a very political bias and little empirical content. We can also turn the argument around and state that the acceptance without any qualms of all these tainted monies actually demonstrates that the system is fully corrupted in the sense that it only targets the 'usual suspects'.

The question about the corruptive effect of crime-money on the financial system remains unresolved. Of course, it has also a quantitative aspect: how much corrupting money is actually in bank accounts and does it have a 'critical mass' to corrupt the financial system? It is surprising (and telling) that there is hardly any empirical data on this issue. Recently Van Duyne and Soudijn (2010; see also Van Duyne and Soudijn, 2009) analysed the confiscation data of the Dutch public Prosecution Office from 1994 onwards, to find any effect of the crime-money within the financial system. From this angle they selected all the items concerning (saving) deposits and bonds and shares. Concerning the deposits, their findings were the following:

174 See article by Amsterdam published in *The Wall Street Journal Europe* on 9 February 2007. Western media has highlighted that many considered the prosecution of Khodorkovsky as politically motivated (see report by Walker, *The Independent*, 2 April 2010; Elder, *The Guardian*, 23 December 2009). Compare comments by Mamchur (2007).

Table 1
Number and amount of the confiscated (saving) deposits

Year	N. persons	Total amount	Median
1994-1997	13	1.946.006	7884
1998	15	604.613	24.352
1999	41	5.959.063	23.483
2000	48	6.103.034	21.340
2001	49	5.887.511	13.468
2002	57	16.170.573	14.933
2003	64	4.741.863	12.393
2004	52	9.105.887	20.000
2005	64	68.279.312	20.588
2006	37	4.388.243	26.674
Total	440	123.186.105	18.058

As table 1 shows, the differences between the years can be significant. In 2005 one offender had three bank accounts totalling €32 million confiscated. Neutralising these exceptions by taking the median, we see that it is around the modest sum of €18.000. Approximately 40% of the confiscated offenders have a bank account with a deposit of less than €10.000. Only 20% have a bank account with more than €100.000.

A subset of this bank account confiscation set consists of foreign bank accounts. 32 offenders appeared to have foreign bank accounts with a total deposit of €15 million, which is 12 % of all the confiscated bank accounts. The median value was also much higher: €93.000. Spread over more than ten years it is not easy to determine the financial effects of these monies on the financial system: its critical mass is too low to have an *observable* effect. And what cannot be observed does not exist.

The researchers also looked at the confiscated bonds and shares. 35 offenders had bank accounts for investment purposes with a total confiscated value (before the financial crisis) of €656.125 (missing values: 16). It is a plausible hypothesis to state: criminals may like to be risk entrepreneurs, but they are not necessarily risk investors.

Indeed, there is hardly solid evidence which can lend support to the firm claims about the disastrous corrupting effect and affected integrity vented by policy makers.[175] What we see is evidence of hypocrisy and covert acceptance

175 As noted previously, policy makers' arguments appear to be centred on drug traffickers and other 'organised crime' groups as well as politically inconvenient funds that circumvent US

of crime money. History, for instance, concerning the privatisation process, demonstrates that crime-money can become accepted and 'gentrified'. Going further back in history, we find, for example, records of the gentrification (see Van Duyne, 2003b) of the US robber-barons' tainted moneys. On the other hand, the crime-money corruption thesis should not be dismissed as a mere chimera: the need for laundering may be accompanied by corrupt practices to which staff of financial institutions may be induced.[176] However, that relates to human conduct, not to the very substance itself: the crime-money. Besides, in the context of the global credit crisis that hit the markets in 2008 and the irresponsible conduct of some stockbrokers and the financial elite, the laundering-integrity issue dwindles into insignificance (Van Duyne, 2008).

b. Social and economic effects

Policy makers claim that crime money and money laundering cause a wide range of effects on the economy and society. However, to specify and precisely analyse the effects of phenomena as broad as these would be an exercise with contentious results.

During his speech at FATF's Plenary Meeting in Paris on 10 February 1998 Michel Camdessus[177] noted:

> "*Money subject to laundering behaves in accordance with particular management principles. There is evidence that it is less productive, and therefore that it contributes minimally, to say the least, to optimization of economic growth. Potential macroeconomic consequences of money laundering include, but are not limited to: inexplicable changes in money demand, greater prudential risks to bank soundness, contamination effects on legal financial transactions, and greater volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.*"[178]

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sanctions but somehow the real corrupting effect of the actions of high-level white collar criminals, such as corrupt financiers and politicians, remains understated.

176 Palmer (2001) suggests that it may be more economical for criminals to corrupt a bank officer in order to gain access to test codes required to issue letters of credit, for instance, than to use computer hackers and internet crime innovation. He further suggests that this can explain FATF's statement (in a press release dated 12 February 1998) that little or no innovation in the use of internet for money laundering has been observed.

177 As noted earlier, Camdessus was the Managing Director of the International Monetary Fund from January 1987 to February 2000.

178 The quote starts with the ninth sentence of the first paragraph after heading "Macroeconomic impact of money laundering" (no page number available as the article was retrieved from the internet).

Summarising the socio-economic effects[179] of money laundering Camdessus also highlighted that these risks were posed by the scale of money laundering transactions: 2 to 5% of global GDP. As reviewed earlier in this thesis, in 1990 the FATF produced estimates of crime proceeds amounting to nearly $300 billion a year, of which about 50-70% is possibly available for laundering and investment in the USA and Europe alone. These figures were not only based on little evidence (Van Duyne, 1994; Van Duyne, 2002b), but were later, light-heartedly as it seems, augmented by international organisations, like the UN, to figures ranging from $500 billion to one trillion a year, figures that appear to be politically convenient (see Naylor, 1999; Van Duyne and Levi, 2005) but arrived at through non-convincing estimation methods. Furthermore, as Van Duyne (2002b) points out, 'available for laundering' soon became the affirmative 'is being laundered'. Thus policy makers and academic literature began to often equate the criminal turnover with the volume of laundering, *i.e.* to attribute these figures both to the amount of crime proceeds subject to laundering and to the volume of the illicit trade altogether (despite the 50-70% fraction figure cited above). And these are two different things. Crime money in need of laundering, in the strict sense of the term, is clearly less than crime money in general, *i.e.* in circulation, part of which is spent on daily needs and other crimes *inter alia*. However, the distinction is blurred due to the commonly accepted broad understanding of laundering, which implies that nearly any use of crime proceeds is laundering. This is exactly where the problem lies with the assessment of and counteracting the socio-economic effects. The effects on the economy and society are contingent upon criminals' intents and ambitions. If a criminal wants to hide his money out of the reach of the tax authorities he would most likely shift it to offshore accounts and keep a low economic profile. Whereas, if a criminal wants to use his money freely and expand his economic powers, for instance by investing in legitimate business, he would behave in a different way. As policy making argumentation does not reflect these considerations, it remains largely conditional (as will be reviewed below) and achieves little.

- *Scope of contribution to economic growth*

The argument that crime money is less productive and contributes minimally to economic growth is only partly valid. It largely depends on criminals' ambitions. Indeed, crime money can be used to further crime and, depending on the crime, it can be productive or not (the counterfeit luxury bags industry in

179 Camdessus, however, does not refer to any specific historica facts.

China or the sex industry, many would argue, are adding a value). Depending on circumstances, investing crime money for the commission of further crime may require laundering. This may particularly be the case in the wholesale smuggling business: the investment in transport (which in itself is productive). Otherwise money can keep circling around in the underground economy without any need of laundering in the strict sense of the term. On the other hand, crime money can also be put to work, *i.e.* invested in productive assets, in which case this money will contribute to economic growth. For instance, cash intensive businesses such as pizzerias, car rental parks and so on, that are often used as fronts to criminal enterprises, can generate some economic activity and employment.

But this is just small fry. If there is any substance to the allegations concerning Silvio Berlusconi,[180] who would deny that his business empire generated national activities and huge employment? Also, political party funds allegedly embezzled by the nomenclature in the former socialist countries may have fled across border but were largely to return and be invested in the economy (this subject will be discussed in more detail in a later section). This means that invested crime money contributed to economic growth. However, while in the case of cash intensive small or medium-sized businesses, enterprises are often a way of laundering crime money, in the second case, the embezzled party funds should ideally already have been laundered before being invested, *e.g.* in privatisation (often investment in privatisation in the former socialist block was done via offshore vehicles without adequate government scrutiny over the origin of the invested funds which facilitated the laundering).

Certainly even money that is put to work can sometimes be insufficiently productive. It is claimed that the investment choices of money launderers (or criminals and their laundering aides) are mostly determined by their need to escape scrutiny by regulators and law enforcement agencies rather than by considerations for investment return. These choices can therefore be detrimental to the economy because, it is claimed, they lead to diversion of capital to assets that generate little or no economic activity or employment (see Bartlett 2002; Unger *et al.*, 2006). McDowell and Novis (2001, p. 8), for instance, point out:

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180 For many years Berlusconi has been the subject of various allegations. As noted earlier, Forza Italia, which he led, was alleged to have been at some point funded by the Mafia. In November 2010 the media also reported that according to a ruling of a court in Palermo, Berlusconi's associate, Marcello Dell'Utri, an Italian senator, was convicted for links to the Mafia and was apparently identified as the liaison person between Berlusconi and Italian underworld figures (see *Agence France Presse*, 19 November 2010; Hooper, *The Guardian*, 20 November 2010).

"*Money launderers are not interested in profit generation from their investments but rather in protecting their proceeds. Thus they 'invest' their funds in activities that are not necessarily economically beneficial to the country where the funds are located. Furthermore, to the extent that money laundering and financial crime redirect funds from sound investments to low-quality investments that hide their proceeds, economic growth can suffer. In some countries, for example, entire industries, such as construction and hotels, have been financed not because of actual demand, but because of the short-term interests of money launderers. When these industries no longer suit the money launderers, they abandon them, causing a collapse of these sectors and immense damage to economies that could ill afford these losses.*"[181]

As a general statement this sounds convincing, but on closer inspection it appears to be a tenuous argument, as it assumes 'sound investment' by owners of licit money. This differentiation can only partly be made. Firstly, the basis for dividing sectors into such that present opportunities for 'sound' investments and such that offer only opportunities for low-quality investments is unclear. Low-quality investments are those that either yield low return or are ill-managed, which is no distinctive feature of investing crime-money. Low- or no-return investments, such as construction of schools, charity and so on, are not necessarily detrimental to the economy. Escobar may not have been regarded as a 'nice guy', but the construction of a neighbourhood he financed in Medellin for impoverished families (see Southwell, 2002) could nevertheless be viewed as a contribution to the community. It would be unwise to label any economic sector as a low-quality investment destination only because the invested funds are derived from crime. Secondly, the distinction between productive and less productive assets and sectors is not necessarily related to whether an investment yields high or low return. Investment in residential houses, art, jewellery, securities, may not generate any substantial economic activity (although real estate agents, art dealers and stock brokers can benefit from this 'criminal' spending), but may actually result in significant profits. Indeed, vast amounts of crime-money may be invested in sectors that generate less economic activity in terms of employment than others. For instance, it is said that the real estate sector is often (mis)used for laundering purposes (see Unger *et al.*, 2006), but it does

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181 The question is how many examples there are as evidence to support this argument. There is indeed speculative construction, especially in emerging markets, but that is not necessarily investment of crime money. In Dubai construction is booming and many buildings are empty but how much of the invested funds are of illicit origin, remains a question. Bankers there appear to be more concerned about money coming from Iran than about the hot money of fraudsters or businessmen running away from creditors.

create added value (as long as the prices go up). On many occasions, for example, the press has reported that the IRA[182] has been laundering crime proceeds through the acquisition of property in Ireland, Britain, Eastern Europe, the Mediterranean and the Caribbean (see Murray and Cusack, 2006). Crime entrepreneurs often buy land, for instance, to build villas (see Suendorf, 2001; Van Duyne, 2002b). However, little empirical evidence is available as to the scale of crime-money investment in the property sector and the assessment of the social and economic impact of such investments remains elusive (see Van Duyne *et al.*, 2009). The evidence from the Dutch confiscation databases mentioned above, table 1 (see Van Duyne and Soudjin, 2010) demonstrates that a major part of the crime-money investments in the real estate sector concerns an average dwelling of €180.000. Naturally, as the distribution of criminal income is skewed, so is the value of the property in criminal ownership: according to the study, there are criminal real estate investors who have attained a more than average property portfolio. But these high-level examples have been thinly spread over time (ten years) and space.

If the threat posed by such investments is significant and laundering takes place on a vast scale, one may wonder why the real estate and property development sector appears to have remained largely under-scrutinised over the years.[183] Besides, property is not necessarily low-quality investment. Additionally, property encompasses also bars, restaurants, hotels and so on, *i.e.* businesses that may, in fact, generate significant economic activity and employment.

The argument put forward by McDowell and Novis misses two other important comparative points: (a) the question: what is the difference between white speculative money invested in real estate (for example from an oil boom) and (b) the empirical observation that probably the majority of wealthy crime-entrepreneurs from the underground economy are inefficient licit managers

182 The Irish Republican Army (IRA) can be described as a paramilitary organisation that has sought to create a united and independent Irish republic.

183 Compared to other regulated sectors, *e.g.* the banking industry, the number of suspicious activity reports (SARs) coming from the estate sector is relatively small (see for instance SOCA 2010 report for UK statistics; also Van Duyne *et al.*, 2009, and Van Duyne and Soudijn, 2009, for an analysis of public prosecution confiscation data relating to the estate sector, including a 2006 report issued by FinCen on illicit financial activities and the commercial real estate sector covering a 10-year period of Suspicious Activity Reports). In the UK the number of SARs submitted by estate agents in 2009-10 was 129. In 2008-09 it was 135. SARs coming from the banking sector totalled 186.897 and 172.030 respectively (SOCA, 2010). In 2006-07 the number of SARs from estate agents was 147, and in 2007-08 the number was 176, whereas SARs from the banking industry totalled 140.437 and 145.905 respectively (SOCA, 2008). However, although the number of SARs from the estate sector is significantly smaller, the figures are still impressive and one may wonder about the extent to which these transactions have been scrutinised.

irrespective of their criminal wealth. Van Duyne and Levi (2005) put together the available case descriptions and noticed a disappointing (or consoling) lack of skills to move economically from the underworld to the upperworld. This suggests that low grade investing is not caused by the need to hide the money from the law, but by insufficient management and business skills. And as far as this management skill is concerned, in what way do they differ from the licit financial bonus hunters who proved to be only loaded managers as long as they did not get into deep water?

Moreover, the observation that criminals are generally not guided by considerations for investment return and therefore tend to invest in less productive or low-quality investment assets and sectors has little evidence to support it. The fact that a crime-money owner (we must differentiate between a launderer as a criminal financial service provider, and the crime-money owner, who inevitably commits self-laundering) may be prepared to invest two illegitimately earned dollars in return for one legitimate dollar does not mean that they are not interested in the highest return possible (see case study of Yakuza's sale of French designer bags below). It is true that crime money can be used as a "*criminal upperworld subsidy*" to establish and sustain unprofitable enterprises to hide tax evasion or for prestige (sporting clubs, for instance) (Van Duyne, 2003b, p. 76). However, such enterprises proved to be typically small or at most medium-sized businesses as far as the Dutch and German research was concerned (see Suendorf, 2001; Van Duyne, 2002b). Research also shows that crime-entrepreneurs often acquire financially troubled, loss-making or highly indebted firms (see Van Duyne, 2002b; Kaplan and Dubro, 2003). However, we can hardly say that in making these choices their only goal is necessarily to remain undetected and that they are not guided by considerations for return. Kaplan and Dubro (2003) explain, for instance, how Japanese gangsters have been allegedly involved in hostile takeovers of firms in financial trouble in order to sell their assets later. They would pocket substantial profits leaving creditors and shareholders empty handed which has resulted in serious economic impact. But it is hard to tell whether it is caused by laundering activities or by a predicate criminal attitude. One may also wonder whether this conduct is essentially different from corporate hostile take-overs or sometimes even the conduct of short-selling hedge funds.

The point is that crime-money's use obviously depends on the criminal's lifestyle, mindset and, ultimately, his intentions. The hedonist will be spending on pleasure seeking. The savvy crime-entrepreneurs (of whom there are probably not that many) and the high-flying criminal tycoons-turned-to-be legitimate businessmen will be seeking to make real investments. The crime-families will consider the accumulated crime-money as family capital and so on. Those who are only concerned about concealing their money to keep it out of the reach of the tax authorities are likely to deposit their money with an offshore bank and leave it there. However, the crime-entrepreneur, like every other businessman, wants to see his wealth grow rather than leave it sitting somewhere or, even worse, let it melt by increasing inflation, credit crunches or poor bank management. And even if he lets his money sit in the bank, the latter will likely not just store the money in the vault, but reinvest it in the form of loans as any normal bank would do. As soon as (crime) money enters the financial system, the logic is that the financial institutions automatically use it to *their* advantage, irrespective of its origin.

An example of an attempt to sensibly invest ill-gotten moneys is the way the Yakuza has handled their funds. It is believed that during and at the end of the Bubble economy[184] in Japan billions of dollars from fraud and intimidation was invested by the Japanese Yakuza into art, property and securities (Kaplan and Dubro, 2003). "*[W]ith so much 'black money' flowing to Japanese politicians from big industries like construction, [the] authorities were not keen to crack down*" (Kaplan and Dubro, 2003, p. 206) which meant that big-crime earners enjoyed a certain level of impunity and could operate relatively unhindered. Thus, it appears that Yakuza's investments were more driven by the insecurity caused by the Bubble economy, which induced them to another risk-avoiding investment, than merely by the desire to avoid law enforcement action. Moreover, it is alleged that during the Bubble period Yakuza also invested in various legitimate businesses and assets in Europe, including a French castle and Vatican holdings (see Kaplan and Dubro, 2003). During the early 1980s Rondan Doyukai, a sokaiya gang, allegedly invested in shares of large European companies, in particular in Rotterdamsch Beleggings Consortium (known as Robeco), Compagnie Française des Petroles, and Compagnie Financiere de Paris et des Pays Bas (PARIBAS) (Kaplan and Dubro, 2003). If true, this would certainly indicate a taste of high-end investment (which does not necessarily require sophisticated crime-money management) rather than low-quality investment choices (see below for considerations on Yakuza's risky operations).

There may also be some instances where crime money brings direct economic benefits to society. The offshore industry thrives on tainted and hot

184 During the Bubble era in the late 1980s rapid increase in asset prices in Japan eventually ended in a market crash.

money. Even reputable financial centres gain from the inflow and deposit of any money: the more, the better, whether tainted or not (see below for reputational downside effects). Peel (2006) quotes a senior Nigerian law enforcement officer saying that approximately 90% of Nigerian state governors have property in the UK and accounts in their own or family members' names. According to this officer, the majority of the money flowing from Nigeria to Britain is "*government-related [. . .] corrupt money being laundered*" (see Peel, 2006, p. 19). Little evidence is available about the scale and techniques of these money-laundering activities. However, Nigerians bring money into the UK, buy properties and thus inevitably contribute to UK's economic growth. The key downside effects, as reviewed below, include potential reputational damage to the UK financial industry, inflationary pressures on the property market and, most importantly, Nigeria losing its national wealth.

According to Unger *et al.* (2006), money laundering in the Netherlands, as a transit country for criminal financial flows, has contributed to positive economic growth (approximately one billion of additional money laundering is estimated to lead to about 0,1% growth). While such debatable estimates should probably be taken with a pinch of salt, there are factual examples of benefits that crime money can bring about.

Manzini (2005), for instance, brings forward evidence of crime money changing the look of entire districts of Benin City in Nigeria. Nigerian women trafficked to Italy to work in the sex industry reportedly send part of their earnings back home to help their families and entire communities renovate the local community. Old houses are being replaced by new buildings. Manzini explains that those few who successfully return home become part of the local elite. The siblings of these women go to the best schools and members of their family stand out because of the way they are dressed. Manzini suggests that such status is likely to be achieved by women who have been actively involved in the organisation of the prostitution ring itself rather than just being a prostitute. Here we can raise the question as to what crime money actually is and in which way it is different from other money. In the case of money sent home from prostitution versus money sent home from licit work in a construction firm (where overtime is paid off the books), what is the difference for the recipient or for the economy at large?

Southwell (2002) points out, as mentioned previously, that Colombia's drug baron Escobar personally financed the construction of an entire district of Medellin for 200 impoverished families. Van Duyne *et al.* (2005) also argues that the financial system may sometimes benefit from the "*surfacing and integra-*

tion" (Van Duyne *et al.*, 2005, p. 125) of crime money. He cites the example of the debt crisis in Latin America during the 1980s when the returning drug money contributed to softening the crisis. Despite the sensitivity of the matter, none of the European lenders (major banks) appeared to have suffered from damage to their integrity (Naylor, 1987). Thoumi (1995) also points out that Colombia's foreign debt was kept under certain limits as a result of conservative monetary policies in combination with inflows of money from cocaine export. It appears that while at that time the US legislator and the UN were preparing to draft laws and conventions to criminalise money laundering, financial institutions were not concerned that part of their loans were redeemed by narco dollars.

However, Thoumi (1995) also notes that crime money is frequently spent on luxury goods imported from abroad (often smuggled), meanwhile benefiting the drug importing and consuming countries. This means slower growth of the local economy (of the drug exporting country) as money is spent outside the country or on items not produced by the local economy. In such instances crime money is indeed less productive which brings us to the point made by Bartlett (2002) and Unger *et al.* (2006) (mentioned above) that criminals' choices can lead to diversion of capital to assets that generate little or no economic activity or employment. But, as touched upon previously, to what extent does this differ from a (licit) financial windfall from other sources like mineral oil? In Russia this did not contribute much to the local manufacturing industry either, as the new-rich elite spent their money on imported luxury items. However, even if this is true, in order to determine the seriousness of its effects, it must be projected against the whole volume of the available risk capital. The question is then: *how much criminal capital remains (to be diverted wrongly) after the usual life style spending*? After all, consumption preferences of the criminal elite do not differ essentially from that of the upperworld elite.

Although crime-entrepreneurs may well be driven by considerations for financial return when investing their crime money (as reviewed above), not all of them are savvy investors. They often trust and overrate their management skills (Van Duyne, 2002b, 2003b), as a result of which their investment outlets may simply go bankrupt (see for some examples Suendorf, 2001, and Van Duyne, 2002b).

However, Van Duyne's point about "*surfacing and integration*" is important as it highlights the fact that criminals' varying financial intentions and types of conduct are crucial and should not be ignored by policy makers. There is a general confusion of money as an economic tool and the social-psychology of the criminal owners. Concealing the proceeds of crime (for instance from embezzlement or tax evasion), *i.e.* keeping the money low-key - below the surface - for a long time, is different from presenting crime money as legitimate and putting it to work. A significant part of the crime money within the global banking system is derived from tax evasion and tax fraud, and much of it is either simply spent on daily needs and maintaining one's lifestyle or is kept in savings accounts offshore. This does not really undermine the banking system, but the state budget system. Therefore different types of financial conduct and crime money management should be interpreted and targeted in different ways.

- *Inexplicable changes in macroeconomic indicators*[185]

Camdessus (1998) points out that money laundering can have macroeconomic consequences such as incomprehensible changes in money demand, unpredictability of international capital flows and exchange rates. McDowell and Novis (2001) also note that money laundering can adversely affect currencies and interest rates. It is also claimed that money laundering can unpredictably change the exports-imports flows (see Bartlett, 2002; Unger *et al.*, 2006). These and similar effects are believed to undermine economic stability.

McDowell and Novis (2001) state that one of the main reasons for the adverse effects on currencies and interest rates is that launderers reinvest their money in schemes which are less likely to be detected, rather than in transactions with higher return rates (discussed above). The other major cause, as frequently cited in relevant literature, is the unpredictable nature of laundering transactions or, in other words, the unanticipated cross-border transfers of criminally derived assets and capital (Tanzi, 1998; Camdessus, 1998; FATF/OECD, 1999; McDowell and Novis, 2001;[186] Boorman and Ingves, 2001; Unger *et al.*, 2006).

However, what are the historical examples as opposed to arguments about hypothetical scenarios?[187] The most frequent verb form in these publications is the subjunctive mood: 'may', 'could' rather than 'is', 'was' and 'did'. There

185 Economic growth is also a macroeconomic indicator but its relation to crime money and laundering was reviewed in the previous section. This section is not aimed at discussing each macroeconomic indicator specifically but rather to summarise relevant considerations.

186 Camdessus, the FATF - OECD (citing the IMF), and McDowell and Novis state verbatim the same effects: "*inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers*." As it appears, much of the rhetoric used in the fight against money laundering is an exact repetition of the same arguments over and over again, based on insufficient factual analysis and is of little help.

187 Few historical examples and little evidence have been provided to support this argumentation. The usual suspects, specifically mentined in the paper of McDowell and Novis (2001), are the European Union Bank, the BCCI and Barings Bank (discussed below).

appears to be little empirical evidence and insufficient research to support these arguments. Moreover, unanticipated cross-border flows will attract attention and lead to reporting to the FIUs. Once again, the arguments about the effects of laundering appear to be only partly true. Firstly, we have to distinguish the movements of the pre-laundered money from the transactions that involve money already laundered. Once laundered, the money does not need to float around, but can be invested as other funds would be. Therefore the arguments about macroeconomic changes do not necessarily always apply and are rarely substantiated by valid empirical references.

Whether macroeconomic effects are to be observed depends very much on the national economy and on the governance of the country. It is plausible that the well-governed industrialised countries with an ample availability of risk capital are less at risk than emerging markets and developing countries. Serbia is a good example of an economy which was exporting huge amounts of money to Cyprus (€2 billion, apparently 'unnoticed' by the authorities) without proper counterflow of goods and services, while direct investments were derived from other countries. No questions were asked, while reports from the Anti Corruption Council about the acquisition of privatised assets with imported shady money do not appear to have received the deserved attention (Van Duyne and Donati, 2008).

As discussed earlier, unless criminals want to simply hide their money and keep a low economic profile, it is unlikely that they would not seek the highest return possible for their investment. Besides, there appears to be little evidence that low-return rate transactions as opposed to high-return investments would in any event adversely affect currencies and interest rates. As to the unanticipated nature of laundering transactions, what the argument apparently conveys is that laundering activities often seem to be economically irrational. McDowell and Novis (2001), for instance, note that launderers usually have short-term goals and their management principles are inconsistent with free market traditions. They further explain that financial institutions which rely on crime capital may eventually run into liquidity problems (presumably because of sudden withdrawals of funds). Further elaborating on this, McDowell and Novis state that, for example, "*large sums of laundered money may arrive at a financial institution but then disappear suddenly, without notice, through wire transfers in response to non-market factors, such as law enforcement operations*" (McDowell and Novis, 2001, p. 7). McDowell and Novis mention as examples the cases of the European Union Bank, BCCI and the 1995 collapse of Barings Bank. However, these three examples do not point to a common (laundering) denominator due to their mutual differences. Furthermore, their demise was not really caused by money-laundering in the strict sense of the term.[188] Besides, whether laundered or not, crime money may indeed move in response to law enforcement action, but this can hardly be described as 'unanticipated' behaviour. In fact, by now, with the existing anti-money laundering control regime, some approximate patterns of crime-money movements threatening the financial system should have been identified after two decades. Indeed, the secretive nature of laundering transactions implies a certain level of mystery but not necessarily economic irrationality. In this respect, the observations of McDowell and Novis and many others appear to be inconsistent. Besides, financial amnesties also involve, to an extent, unanticipated levels of money returning to the country but nevertheless governments are often prepared to consider such measures. A good example was the 2004 amnesty in Belgium.[189] According to some observers, instead of 'getting a clean slate' with the Tax Office, many of those who returned their money back to Belgium started redecorating their houses, refurbishing their kitchens and bathrooms, creating a short-term boom in these industries.

Quirk (1996), who admits that analysis of the macroeconomic implications of money laundering is a difficult exercise,[190] highlights the relativity of the underlying economic phenomena, specifically money demand, when considered in relation to crime and money laundering. Based on economic-statistical calculations, Quirk suggests that a 10% rise in crime can lead to a 6% fall in broad money demand and a 10% fall in currency demand as the related proceeds are being laundered in parallel financial markets. In his theory, Quirk refers to Houston's arguments about the shadow economy. Houston (1990) argues that the presence of underground economy could lead to overstatement of the inflationary effects of fiscal or monetary stimulus. Interpreting Houston's arguments, Quirk says that the increased currency holdings, presumably caused by money laundering, lead to reduced inside money expansion [although this actually concerns cash, including cash under the mattress, rather than laundered money]. At the same time Quirk notes that some estimates show decreased rather than increased currency holdings, which would reverse the argument.

188 The European Union Bank was essentially an embezzlement scam. The BCCI's gradual downfall began largely because of badly handled expansion and risky lending, later fuelled by questionable practices and financial irregularities. The 1995 collapse of Barings Bank was caused by mismanagement and lack of an efficient check-and-balances system.

189 See *Private Banker International*, 31 December 2006; *The Economist*, 6 January 2007.

190 Quirk notes that at the time of publishing his study (1996) there was little literature on the macroeconomic effects of money laundering. Now, after more than ten years has elapsed, quality research is still insufficient (although literature on this matter has certainly grown) while little indisputable evidence has been produced to uphold policy-making processes.

Thus, Quirk admits that there is a degree of uncertainty with regard to the available analysis and estimates of the impact of crime money and money laundering. Broad demand for money and currency demand are variables that depend on many factors and as a result may be incorrectly specified.[191] From Quirk's analysis it appears that the connection between crime rise (hence rise in crime money) and demand for money and currency nevertheless remains disputable. It inevitably raises the question: from whom does this demand for money stem? In addition, what about those 'parallel' financial markets? In a 1997 paper Quirk notes that money laundering methods have changed, moving away from the banking system and cash based economy "*toward parallel financial markets, sophisticated nonmonetary instruments (such as derivatives), and possibly barter (such as an exchange of boats and guns for drugs). If money laundering has moved to the parallel market—that is, debits and credits booked by organized criminal quasi-banks, say, over the Internet—there could be important implications for anti-laundering efforts, which have typically focused on criminal activity at the point at which the proceeds enter the aboveground economy*" (Quirk, 1997, p. 8). But even if the money is laundered via criminal quasi-banks and no-cash, *i.e.* electronic, transactions, does the crime money keep floating there without being converted into other assets, loans or production factors? After all, the aim of laundering is not 'keeping the money on the move', but to settle it as legitimate.

Moreover, such reasoning can be affected by the meaning of the laundering definition. Not all crime proceeds will have to escape to parallel financial markets in order to be laundered. As we know, by definition money laundering involves the concealing of the origin of crime money. However, if we take as an example tax fraud proceeds which constitute a substantial part of the crime proceeds generated in the economy, we will see that once the tax inspector accepts the fraudulent tax form, there is no concealment because the money is 'white' from that moment and integrated into the official money 'machine'. This implies that the tax office is instrumental in the act of laundering. The situation is different when the tax fraud consists of hiding income or savings. That can be hidden physically (banknotes under the mattress) in which case it is not a part of the financial system: it is hoarded and is outside any system. Only when spent, it returns to the normal financial system. When it is placed in an off-shore bank it is part of the local financial system of that offshore country as the off-shore bank will re-invest the money and not hoard it in its vault.

191 Drake (1996), for instance, illustrates possible misspecifications in conventional money demand models relating to the choice and way of aggregation of monetary assets included in the targeted aggregate.

Again, in the strictest sense of the term, laundering involves the ensuring of a legitimate appearance for the money. Once this has been achieved, the money becomes part of the official GNP and can be spent on any item. As a result, as part of the officially recorded money volume, this money contributes to the national economy, irrespective of the economic choices of the (criminal) beneficiaries. The latter can decide to export the apparently clean money or spend it on luxury assets which may have to be imported, thereby contributing to a trade deficit. However, this is not necessarily inherent to crime money or the process of the laundering procedure, but to micro-economic decision-making, which is not characteristic of the crime economy but takes place in the official economy ("plus VAT"). The preference for foreign luxury articles reflects the prevalent fashion rather than some kind of economic criminal mind. Once laundered, there is little reason to export the money. Laundered money is not necessarily flight capital but an enhancement of the buying power.

There are indeed potential effects that are difficult to dispute and these can include distortion of competition[192] and macro-economic data as well as a strain on the macroeconomic balance of a country whereby flows of crime money can create inflationary pressures when outflows of (unlaundered) money leave the country (see below). But again: in what way does it differ from money flows eschewing inflation, bad banking, bad governance and instability?

- *Inflationary pressures*

Van Duyne *et al.* (2005) notes that the surplus of purchasing power above what is officially registered can lead to inflation and this is particularly valid for economic sectors that attract hot money, such as the real estate sector in Northern Morocco and Colombia. According to Unger *et al.* (2006) and Keh (1996), criminals may sometimes be willing to pay more than the market value for certain assets (see further comments below) which can lead to an artificial increase in prices.

- *Distorted competition*

Criminals can usually afford to spend more, or earn less from what they invest, than legitimate market players. Thus they can easily outbid their legitimate rivals, for instance, in public procurement tenders, but without deviating too

192 This, however, occurs in specific circumstances. It would normally apply to economic crime committed by on-going licit enterprises (in the construction industry, for instance, there may be some unfair competition due to black labour fraud). These hardly pass their cost reduction on to the customers and if they do, they would probably seek to avoid alerting competitors who would not waste any time in alerting the tax authorities. This means there is little latitude to deviate too much from an average cost price without attracting law enforcement attention.

much from an average cost price as this could attract law enforcement attention, as mentioned previously (another matter is that sometimes corruption is so endemic that criminals end up paying less than legitimate businesses by offering kickbacks to corrupt officials rather than beneficial financial terms to the state). Moreover, criminals can easily raise cash without the burden of paying interest on loans. As a result, they can give a financial boost to their enterprises (*e.g.* restaurants, car rental firms and so on, which in economic terms is usually small or medium-sized investment with local influence, see Suendorf, 2001; Van Duyne, 2002b and Van Duyne, 2003b), while legitimate businesses do not always have easy access to funds (Van Duyne, 1998). This means that criminals gain a competitive advantage over legitimate businesses which distorts competition (see Arlacchi, 1986; Walker, 1995; Keh, 1996; McDowell and Novis, 2001; Unger *et al.*, 2006). However, these general statements do no justice to the fragmented nature of the crime-economy. In the majority of economic sectors crime money is also generated within licit companies, for example in the construction industry, by fraud and cartel conspiracies (Van Duyne and Van Dijck, 2007a), and perhaps to a much larger extent than in the underground economy.

An interesting example of a crafty laundering technique (not just the availability of quickly raised cash) which can negatively impact fair market competition is the following case study:

> Investigators discovered a scheme Yakuza used in the late 1980s and early 1990s, which involved the purchase of French designer luxury goods, such as Louis Vuitton, Channel and Hermes clothing and handbags in France. The gangsters used Japanese, Chinese and Vietnamese students to buy luxury goods in upmarket French shops. The students paid with money wired by gang members from Asian banks to Paris via Luxembourg, Switzerland and the Channel Islands. The purchased goods were then exported to Japan and sold through a front company. The crime money invested in purchasing the bags and keeping the entire operation running apparently exceeded the seemingly licit turnover. The balance, however, had a legitimate appearance. Reportedly, over six years, the gang managed to wash about $75 million (perhaps a modest amount for the criminals but quite substantial for ordinary people). The ring was busted by the French and Japanese police in April 1992. The authorities discovered that the gang had been helped by a corrupt French customs official. (Kaplan and Dubro, 2003)

However, instances of such successful and elaborate laundering operations are exceptional. Inevitably, for this operation to successfully run for over six years, it had to involve corrupt customs officials prepared to turn a blind eye to forged documents and facilitate the export without questioning it. The ring would also have had to include corrupt officials on the Japanese side.

- *Outflows of crime money*

The outflow of illicitly generated crime money, which sometimes forms part of capital flight, may also have implications for the economy. Developing countries are particularly susceptible to the downside effects of such outflows of crime money and, capital flight in general, as it immediately impacts their scarce investment capacity and reduces the rate of national savings. This, in turn, badly affects the economic growth of a country. Having said that, it should be noted that, essentially, there is no difference with the 'licit' flight capital. Furthermore, laundered capital will not necessarily leave the country, unless it faces the same adverse conditions as licit capital: galloping inflation and instability as mentioned below.

Such outflows can include both sorts of money – money that is seeking to escape law enforcement and regulatory scrutiny and money that is seeking to undergo (further) laundering (these can overlap). In the latter case, this money may well return to the country of origin (or possibly move to the country of residence of the criminal where he can enjoy the fruits of his deeds, if that is different from the country of origin). But what is important to note is that such outflows are not necessarily 'unanticipated' or 'irrational', especially when they form part of capital flight. Capital flight does not necessarily consist of crime money that is leaving the country for laundering purposes and, in addition, is also far from irrational. Massive outflows of money are usually caused by domestic economic instability, high tax rates and other factors such as inefficient banking services that make domestic investment and saving less advantageous than investment and saving abroad. As it is usually triggered by certain economic or political events theory models can predict the risk of its occurrence. Additionally, the money flows must be related to the nature of the market and the country where the major profits are made. As far as the drug markets are concerned, large profit margins with a sizeable surplus which must be managed, occur within the rich industrial consumer countries at the import and first distribution level (Reuter and Greenfield, 2001). But at the end of the distribution chain where the turnover is low and dealers are largely consumers themselves, the surplus above own (often drug) consumption and spending does not require special laundering measures. The outflow of 'narco dollars' or euros does take place but is likely to be only a small part of the total money movement from those countries. In contrast, the outflow of corruption money out of small and fragile economies has a much more detrimental effect.

- *Distorted basis for policy making*

Tanzi (1998, p. 12) highlights that the outflow of $20 billion out of a country can cause "*confusion for policy makers*." This applies not only to the outflow of money but to inflows and domestic expenditures that are beyond the registered levels. As Keh (1996) points out, criminal flows are beyond government control and spending behaviour becomes influenced by unregulated factors, such as informal credit. Criminals have access to unofficial money supplies and generate domestic activity that remains largely unaccounted for. Thus, the use of crime money is, by its very nature, part of the shadow economy, implying an unlaundered existence. That said, it should also be noted that the underground economy is considerably far more fragmented and less developed than the licit financial economy with its institutionalised credit facilities. Within the underground economy money changes hands on a personal level and usually within a small (family) circle of trusted people. The Hawala system of money transfers is a good example of how significant amounts of money can be transferred abroad. However, it appears it had never attracted as much attention and had not been considered a significant threat to policy making until the revelation that it had apparently been used by Osama Bin Laden's al-Qaeda network. After the terrorist attacks of 9/11, Hawala became increasingly the target of attention by the US and other national authorities.[193]

In addition, in the strict sense of the term, laundering performs a transition or a 'bridge' function: it makes the unregulated regulated by legitimising it. This can be performed by a launderer such as a financial service provider, the criminal himself, or the tax administration, which is the ultimate laundering mill (Van Duyne *et al.*, 2003).

Quirk (1996) notes that fiddling with unaccounted money may lead to an incomplete or even misleading picture of the amounts of generated and spent money. He concludes that money laundering can distort economic data and thus also distort macroeconomic analysis and policy making. Again, we should note the importance of distinguishing between the various meanings of laundering. It is mainly the unlaundered money (that has not surfaced and has yet to

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193 See report by Anderson, *BBC News Online*, 2001.

integrate into the legitimate mainstream) that distorts economic data. In fact, money laundering, in the strict sense of the term, restores data.

While such distortion of economic data (due to unlaundered money) remains a real possibility, this reasoning should not give rise to moral panic. McDowell and Novis (2001) are adamant that money laundering takes the control of economic policy away from the government. However, such argumentation, albeit in a worthy cause, appears to be misguided rhetoric aimed at magnifying the real difficulties to justify the expanding control regime. As remarked above, laundering, in the strict sense of the term, in fact, brings the illicitly derived proceeds into the realm of the official economy. Moreover, it can be regarded as the 'Achilles Heel' of criminal activity by which offenders can be identified, as will be discussed later in this thesis.

The problem is that in their attempt to demonstrate the correctness of their arguments, policy makers use all-inclusive, vague, but commonly endorsed concepts (as we will also see further below). Given the general acceptance of this 'copy-paste' line of ill-defined arguments, their rhetoric is astonishingly successful. But it remains a question as to how much is achieved in terms of effectively fighting profit-oriented crime.

- *Effects on tax collection*

It is also claimed that money laundering can decrease tax revenues as laundered money evades tax (McDowell and Novis, 2001; Unger *et al.*, 2006). However, once again it appears that the process of reasoning stumbles over an ill-defined problem (or political mainstream correctness). On the one hand, any use of money which evades tax can be regarded as money laundering due to the broad definition of the latter. On the other hand, crime money which is effectively laundered, in the strict sense of the term, resurfaces and integrates with the licit economy. This means that criminals will inevitably have to pay tax on these recorded assets and income. If crime money stays in the shadow economy (*i.e.* does not get laundered, in the strict sense of the term) it will remain untaxed as long as it remains secreted away or 'hoarded'. However, financially and economically hoarding is a primitive conduct as it prevents money performing its basic role of making transactions efficient. As a matter of fact, it means a temporary withdrawal of money from circulation. One may wonder whether, and to what extent, this may be more damaging to the licit economy than laundering. Hoarding usually takes place by amassing and hiding banknotes of high denomination, such as the €500 banknote. Like the previous DM1000 DM or the NLG1000, large banknotes were kept not only by crime/drug entrepreneurs, but also by farmers (particularly horse traders), car dealers and elderly people, who had more faith in their own rustling banknotes than in the bank (see Boeschoten and Fase, 1992). To an extent they proved to be right. However, this is also relative as money cannot keep circulating for ever in the underground economy like in a kind of monetary "*aquarium*" (Van Duyne, 1994b, pp. 54-55). In the end it all ends up at the inevitable tax mill because of spending on taxed goods and services, such as holidays, cars and healthcare.

Some authors also point out that an increase in predicate offences and money laundering activities triggers public enforcement expenditure (Unger *et al.*, 2006). So if increased enforcement expenditure means that predicate offences and laundering will decrease, then fighting laundering reduces in its turn public enforcement spending. This argument hinges on the assumption that there is a causal relationship between the predicate offences for profit and laundering on the one hand, and enforcement on the other hand, such that the fight against laundering reduces the level of profit-oriented crime. In a rationally balanced world this seems a plausible thesis, albeit of a sweeping generality. As a matter of fact, the findings in the drug market belie this consensual wisdom. We have here the picture of falling drug prices (since 1986), changing, but not decreasing consumption[194] on the one hand, and a decrease in property crime on the other hand.[195] This suggests a correlation between drug prices and property crime to pay for consumption. However, that would be jumping to conclusions, because a more determining circumstance could be the greying population: the reduced perpetrator group in the age range of 16-24. And where can we project plausible effects of anti-laundering policy?

Apart from that, we have already seen that the cash-based underground economy is quite different from the sector of economic crime, particularly elite crime.[196] Both sectors are themselves subdivided in types that have little in common. Indeed, there is little evidence that –after almost 20 years – the present global anti-laundering regime has achieved any significant results in terms

194 United Nations, Office on Drugs and Crime, *World Drug Report*, 2007, 2008, 2009 and 2010.

195 Levels of property crime during this decade are generally lower than during the 1990s. According to a study completed in 2005, there has been "*near universal decrease in overall levels of crime in the Western world*" but most pronounced in property crimes such as car thefts and household burglaries (Van Dijk *et al.*, 2007, p. 24). For instance, according to UK government statistics, the number of domestic burglaries in England and Wales as of 2005-07 has decreased about twofold compared to ten years earlier (UK Home Office Statistical Bulletin, 2008/09).

196 Elite crime, subspecies of which are corporate and white-collar crime, and corruption of officials, is, as sociologists define it, crimes perpetrated by individuals of high social status in the context of their occupation (see Sutherland and Cressey, 1978; Andersen and Taylor, 2005; see for comments on this subject Gelemerova, 2010).

of reducing the level of crime. Despite the reporting of some relatively negligible results, only the associated expenses proved to be significant.[197] Anti-laundering requirements have created an entire anti-laundering complex of 'problem-owners' ranging from regulators to regulated entities, all trying to solve an ill-defined problem on the basis of unclear criteria (see Harvey, 2003; Verhage, 2008; Gelemerova, 2008). But problem-owners, (meaning here regulators) are seldom problem-solvers: in fact their ever-widening powers thrive on the magnitude of the problem.

So instead of making generally accepted sweeping statements, in order to use the relationship between predicate offences and enforcement expenditure as an argument in policy making, we should first refine the basis for a well-defined problem definition, achievement measures, proper stocktaking and critical inspection of the available data.

- *Soundness of the financial system*

It is said that crime money can affect the soundness of the financial system (Camdessus, 1998; McDowell and Novis, 2001; Unger *et al.*, 2006). Easily gained crime money can be associated with risky operations (see Unger *et al.*, 2006) and the resulting financial speculation can seriously affect the market. For instance, Kaplan and Dubro (2003) suggest that Yakuza's laundering activities, specifically their apparently risky operations, in the late 1980s and early 1990s (during and at the end of the Bubble economy[198]), caused damage to the economy and society of Japan. Japan's top mobsters quickly learned the craft of stock speculation and greenmail[199] (Kaplan and Dubor, 2003). Yakuza's taste for high-risk operations apparently stemmed from its ability to easily raise quick cash in large amounts. In addition to proceeds from extortion and other criminal activities, Yakuza also had access to credit, with which it bought stock and real estate. When the Bubble burst, prices of stock and real estate dropped dramatically. As Yakuza largely failed to repay its loans, banks and other financial institutions were led to the verge of bankruptcy (see also Mano, 1998; Kattoulas, 2002; Fabre, 2003; Manabu, 2005). Thus, it is believed, Yakuza's speculative market transactions contributed, in the first instance, to the emergence of

197 For instance, in the UK "*the annual spend on anti-money laundering compliance*" has been estimated at £109 million for all industry streams (Pricewaterhouse Coopers LLP, 2003, p. 58).

198 As previously noted, during the era of the Bubble Economy in the late 1980s rapid increase in asset prices in Japan eventually ended in a market crash. There is a view that economic bubbles can be caused by speculation in stocks, which is often followed by a financial crash.

199 'Greenmailing' is the practice of acquiring shares in a firm in order to threaten a takeover and thereby pressurise the target firm into buying those shares back at a premium in order to suspend the takeover (Downes and Goodman, 2006).

the Bubble and, then, to delaying the post-reconstruction of the financial sector.

However, while Yakuza's criminal activities were undeniably a calamity for Japan, the extent to which Yakuza's crime money *per se* contributed to the collapse of the economy is disputable. What fuelled the crisis was an unhealthy social mixture: Yakuza's predicate crimes (loan sharking and massive bank fraud among other crimes) and the unwise lending policies coupled with the complex financial relations. This took place in the traditional financial structures and existing 'clientelism' within the Japanese financial sector (see Hafner, 2002). It seems that the apocalyptic tendency for stock speculation was a general market trend rather than a characteristic exclusive to Yakuza.

So it appears that we have here another piece of unfounded rhetoric. While investment in the stock market and financial derivatives can indeed be an efficient way of laundering (see Hafner, 2002) (if one succeeds in avoiding the paper trail), there is little evidence that criminals prefer risky operations or are inclined to engage in risky operations more than the average businessman. As a matter of fact, research on confiscated criminal wealth shows that criminal 'high earners' did not gather 'abstract' assets like shares.[200] As discussed earlier in this thesis, Sindona's alleged high-risk financial transactions contributed to the collapse of his empire. Risk is risk to anyone, whether a criminal or a legitimate businessman, and a criminal can lose as much as a legitimate businessman while in addition he faces a tough debt settlement. A range of other factors such as, for instance, circulation of oil money coupled with bad governance and, most importantly, corruption, are as much (or probably even more) likely to bring about serious downside effects on the macro-economy of a country (see Coronil, 1997; Collier, 2007; Ghazvinian, 2007). That does not mean that crime money investment should be tolerated. But that is a moral issue. However, targeting it as a top priority based on financial market arguments requires a better foundation and improved tools. It is not the crime money *per se* but the type of crime-money *earner* that gives rise to a particular type of financial conduct, whether it is unanticipated, risky or irrational.

- *Loss of trust in the financial system*

Quirk (1996) points out that crime money and money laundering may have led to a weakened confidence in financial markets. But what is the evidence? This

200 In the Dutch research this amounts to 0,097 % of the confiscated value (Van Duyne, 2003). In the continued research project the attention will again be on 'high-level' economic activities, like the real estate sector. Thus far crime-entrepreneurs prove to be an utterly (licit) economic disappointment (Van Duyne *et al.*, 2009; Van Duyne and Soudijn, 2009 and 2010).

may be valid for economically underdeveloped or unstable countries, or stable countries in the midst of a financial crisis, but this lack of confidence is rather caused by the careless service of banks and the lack of trust in the financial policy of the state. It is bad service that irritates people and a poorly managed bank that frightens them. The collapse of the rouble taught Russian savers a lesson, not about laundering, but about bad banking and untrustworthy financial policy (see Stiglitz, 2002). The 2008 credit crisis taught savers a global lesson about trust in the financial system. The public is not afraid of launderers, but of bankers who cannot return their savings (see also Harvey, 2005 and 2007). Also, at the time in which sensational stories abounded about serious criminals banking in Switzerland, 'respectable' tax evaders were undeterred and continued to deposit their hidden savings at Swiss banks.

The loss of trust in a financial system can adversely affect the economy (Tanzi, 1998; McDowell and Novis, 2001). Having said that, the usual examples mentioned by the majority of authors refer to a phenomenon that is not necessarily money laundering in the strict sense of the term (see below), but some form of financial crime, or crime money logistics, combined with inefficient banking management and bad governance.

- *Crime money infiltration or crime money generation?*

Arlacchi (1998, p. 5) notes that "*globalisation has turned the financial system into a money-launderer's dream and that criminal process siphons away billions of dollars per year from economic growth at a time when the financial health of every country affects the stability of the global marketplace.*" He further notes that the infiltration of crime money, albeit sometimes in small amounts, "*may prove a catalyst for a chain reaction*" of unforeseeable magnitude (Arlacchi, 1998, p. 7). The reason for that, according to Arlacchi, is that criminal entrepreneurs bring into the legal market "*fresh strains of adventurism and anarchy*" (p. 7) that can cause a worldwide financial breakdown. Arlacchi brings forward the old and over-quoted cases of BCCI, the European Union Bank of Antigua and Bank Ambrosiano[201] as examples of the collapse of financial institutions due to illegal dealings and use of offshore secrecy.

When discussing the macroeconomic aspects of offshore money laundering, Tanzi (1998) also points out that scandals such as the BCCI and the European Union Bank ultimately led to the loss of trust in the international financial sys-

201 However, of these three examples (BCCI and the European Union Bank of Antigua have been referred to elsewhere in this thesis) only Bank Ambrosiano (also discussed earlier) was purposefully turned into a money laundering vehicle in the strict sense of the term.

tem. McDowell and Novis (2001) also refer to the same examples, as well as the Barings Bank collapse, highlighting that criminal activity can result in bank failures. McDowell and Novis further note that financial institutions which rely on criminal capital face challenges in adequately managing their assets, liabilities and general operations (as mentioned earlier).

To an extent this may be a valid point. However, it is important to note that such institutions are not necessarily part of the sound banking system and are usually isolated and often short-lived phenomena that are bound to end, not in a take-over but in collapse due to insolvency. Moreover, this is again comparing apples and oranges: these banks collapsed for different reasons. It would be helpful to differentiate between banks which are used for laundering, banks which operate as financial pyramids and banks which are perfectly legitimate but have been misused for criminal purposes, often by their own staff. The owners of the European Union Bank, for instance, were thieves rather than launderers (in the strict sense of the term) (see Van Duyne *et al.*, 2005). Barings Bank is altogether a different case. It was a classic example of accounting fraud that occurred due to the lack of an adequate internal check-and-balances system. If we are to interpret the broad definition of laundering, by hiding his trading rogue trader Nick Leeson was in fact hiding the origin of his potential gains (ultimately mainly losses). In a way, this case is an illustration of laundering of losses rather than of gains but this is an over-stretched interpretation of the laundering term. These references, such as the reference to Barings Bank, represent rather a continual recycling of only a few examples, some of which have little to do with laundering but serve the purposes of policy makers.

The series of bank failures (as opposed to isolated cases) which occurred during the financial crises in Central and Eastern Europe and Russia during the 1990s were largely caused by mismanagement, asset stripping, misappropriation of funds and bank fraud rather than money laundering *per se* (another matter is that laundering was taking place on a large scale too). It was not so much a question of crime-money infiltration but a question of crime-money generation. The process of crime-money generation was largely facilitated by corruption, sometimes with lethal violence[202] and bad governance. For instance, according to the IMF (1997), the severe financial crisis in Bulgaria was caused by the slow pace of structural reform and the lack of financial discipline in the banking sector. There were no efficient regulations in place, and the ones that

202 Specifically, the Russian media has widely reported on a series of murders of Russian bankers throughout the 1990s and well into the 2000s (see a chronology of some of the murders in *Newsru.com*, 14 September 2006).

existed were not effectively enforced (see Baloun and Scheinost, 2002 and 2003, for an account of similar developments in the Czech Republic).

Indeed among such bank failures were also cases of what appeared to be money laundering (both in the strict and broad meaning of the term) in combination with mismanagement and fraud:

> This appeared to be the case with the Bulgarian Balkanbank. It was founded in 1987, *i.e.* prior to the market reforms in Bulgaria, as an industry bank in the machine-building sector. In 2002 Ivan Mironov, the bank's former director, was charged with abuse of office. According to prosecutors, in the early to mid-1990s he allowed the granting of 30 loans, mostly with no adequate guarantee, to 22 companies. As the loans were never repaid, the financial burden on the bank apparently led to its bankruptcy in 1997.[203] Reportedly, a considerable number of the bank's debtors were companies affiliated with the infamous Multigroup,[204] the owner of which, Iliya Pavlov, was murdered in 2003. Iliya Pavlov has been alleged to have handled and laundered money misappropriated by the former socialist regime nomenclature.[205] However, Mironov was acquitted in 2006.[206]

In effect, the loans from banks that went bankrupt during the 1990s may well have been partly used for money laundering but as the money was never (fully) returned, it was imperfect laundering because of the scrutiny it attracted. Thus it appears that the banks' collapse was, after all, caused not by crime money infiltration but rather by crime money generation and the lack of adequate control. Indeed, fraudsters take the money *out of* the bank, launderers bring it *into* it.[207]

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203 *Expert.bg* of 12 June 2006, *The Sofia Echo* of 8 January 2004.

204 *Mediapool* of 12 December 2002.

205 According to General Atanas Atanasov, former head of the National Security Department of Bulgaria's Ministry of Interior, many of those who were "*connected with the genesis of smuggling channels and received funds from the former communist party were now being liquidated [killed]*" apparently referring to the murder of Iliya Pavlov (see Nanev, *Maritsa*, 21 August 2003). The former speaker of left-wing ex-prime minister Zhan Videnov, Krasimir Raydovsky, said in an interview for *Darik* radio on 14 March 2003 that in the early years of the transition period, business was established with party funds. He said "*future capitalists were given money from the membership fees of the former Bulgarian Communist Party*." He noted that Iliya Pavlov's business empire Multigroup was founded by the "*party-state*".

206 In several other cases of Bulgarian banks that went bankrupt during the 1990s, the suspected culprits were eventually acquitted as prosecutors apparently wrongfully charged them with abuse of office under a provision that was supposed to apply only to state officials. Some of the bankers later even sued the Bulgarian state for moral and material damages (see Iliev in *Banker*, 11 January 2008).

207 Another example is the phenomenon of 'tunnelling' within the banks in the Czech Republic as described by Baloun and Scheinost (2003)

- *Furthering outlawed activities*

Crime money can be used to further outlawed activities including corrupt practices and terrorism. Bandurka and Simovian (2003) illustrate how proceeds from drug trafficking were used to finance terrorist activities, buy arms and hire mercenaries in Chechnya and Afghanistan. Crime-money can also be used to bribe officials, bankers and judges; it can be invested to equip laboratories for the processing of drugs or the supply of printing equipment to forge banknotes or to cover other business costs. However, the organisation of many crimes, specifically fraud schemes, requires little (*i.e.* telephone, e-mail, letter heading, straw man) or almost no investment at all. Besides, even where there is investment in crime, it does not necessarily involve any laundering in the strict sense of the term. Indeed, gathering intelligence on potential laundering activities (which will be discussed later), within the remits of the broad laundering definition, can be a useful tool to identify leads to predicate crimes. However, trying to root out laundering in order to prevent or eliminate all kinds of profit oriented crime seems to have little effect (exceptions include crimes such as some financial fraud schemes which can indeed be prevented through a rigorous but well-targeted financial control regime).

- *Reputational risks*

A major undesirable effect of crime money and money laundering is the associated reputational risk (McDowell and Novis, 2001; Clark and Vickers, 2002; Bandurka and Simovian, 2003; Unger *et al.*, 2006). To an extent, reputational issues are intertwined with the same argument as the integrity and soundness of the financial system (which was discussed above). Organisations which in any way (even negligently) deal with crime-entrepreneurs or handle tainted money risk reputational damage. It is claimed that revelations, suggesting that a financial institution or any business has been in any way connected to laundering activities and crime money, can scare off clients, partners and investors resulting in the decline of business and subsequent financial losses in addition to possible regulatory penalties (however, there is little evidence that clients have been easily scared off by such revelations with regard to banks in tax heavens). Such losses can, to an extent, quantify the reputational risk and damage that is otherwise difficult to measure. But a proper differentiation must be made between reputational risks due to involvement in crime for profit and risks due to providing only laundering services.

For instance, *New York Daily News* had to deal with serious reputational issues after Robert Maxwell reportedly used it as a laundering vehicle for the money he siphoned off from the London pension fund of Maxwell Mirror Group Newspaper PLC in 1991. The news group had to undergo expensive lawsuits to prove that it had not benefited from the illicit transactions and that it had not been directly involved in their organisation.[208]

The reputational risk can extend to whole sectors and countries. It is claimed that if specific economic sectors are perceived to be vulnerable to money launderers, this may have a 'dampening' effect on foreign direct investment (IMF, 2010). Southwell (2002) also notes that in weaker countries criminal business fronts (and within the broad laundering concept, using a front is equal to laundering) often out-compete or terrorise their legitimate rivals, thereby scaring off investors from entire sectors. For instance, this has been the case in Bulgaria when, in the early 1990s, extortion businesses functioning as insurance firms made it difficult for some legitimate insurance providers to exist. Other small enterprises also suffered from their intimidation. However, there is little empirical evidence that money-laundering fronts (*i.e.* in the narrow sense, as a criminal financial service) would function in the same way as other criminal business fronts operate. It is unlikely that any business that is used to launder money would work in a way that would allow out-manoeuvring other players in the market in an obvious manner. Instead, money-laundering fronts seek to maintain a low profile: their task is to hide and disguise, not attract attention. That said, it would be a different matter if money laundering is understood broadly – in that event any business that evades or has evaded tax at some point or has in any way been associated with tainted money could be viewed as a 'money laundering' front which would be an overstretched application of the term.

Nevertheless, reputational risk is a real and undisputable potential effect and the growth of the risk management and due diligence industry is proof of the growing awareness of this risk. But it seems that these days due diligence[209] is

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208 According to Judge Tina Brozman, Maxwell used the US tabloid *New York Daily News*, which he acquired in March 1991, as a "*money laundering device*". Brozman stated that Maxwell and his associates could siphon funds from *Daily News* accounts and transfer them "*to and from Maxwell-controlled private side and public side entities in furtherance of their own private agenda*" (Arena, *Newsday*, 10 March 1994). The majority of the $200 million claims against the bankrupt *New York Daily News* came from former Maxwell's companies, including Britain's Mirror Group Newspaper. The laundering scheme included the transfer of funds siphoned from these companies to New York bank accounts in the name of *New York Daily*, where the funds would be deposited for several hours or one or two days, and then transferred elsewhere (Sanger, *Newsday*, 16 June 1992).

209 The term 'due diligence' is generally understood to be the use of procedures aimed at verifying facts and the identity of a customer or a partner. The meaning of the term has gradually been broadened to include examining the background, integrity, sources of wealth and extent of po-

increasingly becoming a matter of compliance rather than a matter of sound risk management practice (this subject will be touched upon in a later section). At the same time, there is little evidence that the high cost of compliance with the current regulations is outweighed by the benefits these regulations are supposed to provide (see Harvey, 2007). As compliance is largely based on vague concepts and insufficiently clear guidance (see Gelemerova, 2008), turning into "*compulsive excessive regulatory disorder*" as defined by Van Duyne (2008, p. 1), many businesses tend to over-comply, even though over-compliance does not necessarily achieve the desired outcome (Harvey, 2007). Moreover, it appears sometimes that it is just the regulatory reprimand for inadequate anti-money laundering control systems with subsequent over-exposure in the media, rather than the connection to any specific criminal activity, that may cause reputational damage. Even the slightest hint that laundering *might* happen is sufficient for large scale media coverage, including a camera crew in front of the office, as happened with Holland Casino in the late 1990s.[210]

Besides, it is ultimately the occurrence of unethical practices rather than the inflow of crime money *per se* that can destroy the trust in an organisation and eventually result in withdrawal of business (see Van Duyne *et al.*, 2005). Furthermore (as reviewed elsewhere in this thesis), when discussing the risk of reputational damage, we cannot avoid addressing the question: beyond what point is illicitly derived money no longer tainted (see Van Duyne *et al.*, 2005) and therefore no longer associated with a reputational risk? (This issue will be touched upon in a later section). We have seen a process of evolutionary cleansing of wealth ('gentrification', as discussed earlier) not only in Russia and Eastern Europe, but also in the USA and other western countries. Should banks never accept the money of oligarchs or heads of states only because they may have been, at some point in the past, involved in questionable dealings? After all, in its non-physical form, as a *claim*, money is virtually indestructible and therefore retains its past.

We also have a range of smells and colours for all sorts of other money, *e.g.* from oil and diamond proceeds to 'hot' money shifted offshore by wealthy

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litical exposure of a customer or a partner ('enhanced due diligence'). Palmer (2001) notes that the concept of 'due diligence' has its roots in the legal concept of a 'duty of care' which is a 'duty to enquire' further where deemed necessary.

210 In 1997 the media reported that Theo van Keulen was forced to resign as the president of Holland Casino amidst a scandal involving tax evasion and money laundering allegations. In 1998 he was sentenced to six months in prison or 240 hours community service for his role in the alleged money-laundering ring (see report by Bos in *International Gaming and Wagering Business*, 1 December 1997; *Agence France-Presse*, 26 February 1998).

individuals and rich corporations. In this confusion of colours businesses may find themselves in disarray, seeking to find the right balance between reputational risks, as far as these really matter, and profit targets. However, regulators provide no recipe for how to deal with this.

Interestingly, prior to the US launching the war against money laundering and Switzerland coming under pressure to tighten its control system, hardly anyone had any qualms about investing in Switzerland and any fear of reputational damage. The Nazis and the Jewish community, the drug dealers and the secret services, the fraudsters and the bourgeois tax evaders alike believed they could safely keep their money in Switzerland, but the Swiss economy barely suffered any reputational damage. In the 1980s the tide was turning. In various publications Switzerland was accused of being the best 'white washing' country (see Ziegler's "La Suisse lave plus blanc" or "Swiss Whitewash", 1990, and Bernasconi's "Finanzunterwelt" or "Financial Underworld", 1988). Furthermore, Swiss banks were frequently mentioned in the context of various banking affairs, like the Banco Ambrosiano affair. Nevertheless, even with some stains on its blazon, the flow of customers and monies to Switzerland did not dry up. The same applies to its neighbour, Liechtenstein. This raises the question of the empirical evidence of a causal relationship between money laundering accusations on the one hand, and investment withdrawals because of the reputational loss on the other hand.[211]

Maybe we should look at 'reputational risk' differently. With the socio-political construction of laundering, the authorities created a new reputational risk of 'untrustworthiness'. This is not about cheating or prejudicing clients, but 'helping criminals'. And because non-compliance is easily equated to 'helping criminals', now every company and state is cautious about its reputation. The authorities have achieved this partly by 'copy-paste' recycling and indiscriminately throwing together various examples, some of which are not money-laundering in the strict sense of the term, but which apparently help strengthen the popular "*threat imagery*" (Van Duyne , 2010, p. 356). However, there is no evidence that in this respect the authorities reflect any public concern, as until

211 In 2002 the UK Financial Services Authority fined the Royal Bank of Scotland for money laundering control failings (see FSA, 2002). In 2009 the media reported (see Mann, *The Miami Herald*, 11 May 2009) that Lloyds TSB Bank, an international bank based in the United Kingdom, agreed to pay $350 million to the US authorities for violating US federal and New York state laws. Lloyds TSB was found to have falsified information on electronic fund transfers from Iranian and Sudanese banks to US banks in violation of US sanctions and trade restrictions (this subject will be discussed again later in this thesis). The violations equalled to money laundering. However, it remains a question whether this has scared off any of these banks' customers.

now the affluent normal citizen continued to look for financial secrecy services delivered by efficient and trustworthy banks. As he is looking for such services for concealing his own assets, he and other similar customers know very well that this is just a euphemism for laundering. As long as the financial institution has the reputation of returning their (concealed) savings, they will feel little concern about reputational risk related to money laundering. From this perspective 'reputational risk' is a construction largely shaped by regulators and law enforcement agencies. This does not mean that it is a soft concept: once an institution has been labelled as associated with money laundering, it faces serious consequences,[212] but not necessarily from customers.

c. The moral issue

While the enforcement of the anti-money laundering regime appears to have been supported with somewhat misguided or insincere rhetoric and have been undermined by the lack of sufficiently methodical research, the key point of the regime should not be dismissed. Above all, money laundering allows criminals to thrive and enjoy their proceeds. It ensures that crime pays and this is why anyone who facilitates it deserves to be punished.

> A good example of how laundering can help to ensure impunity appears to be the case of the Bulgarian businessman Konstantin Dimitrov who was killed in 2003. Dimitrov, also known as Kosyo Samokovetsa, was alleged to have earned millions of dollars from contraband trafficking in the Balkans and was investigated for money laundering. In late 2006, three years after his murder, the authorities launched a money laundering investigation against his widow, Angelina Dimitrova. In anticipation of Bulgaria's accession to the EU, the general prosecutors' office stated that it had compiled a list of individuals whose property was potentially the subject of confiscation under the Law on Confiscation of Illicitly Gained Property. One of the first cases initiated under the law was against Angelina Dimitrova. However, the outcome of the case was widely reported by the press as 'a fiasco'. According to the forensic examination by auditors, lawyers and investigators, Dimitrov's records listed as a source of licit income what appeared to be quite a successful potato production business, amongst other things. When he was murdered in 2003 his wealth (including assets in the UK) was estimated at $60 million. Yet in 2006 the authorities managed to confiscate only a small fraction of it: assets that cost $39.000 at the time of acquisition by Dimitrov

212 Including penalties and sometimes costly trials.

that were now estimated at about $150.000. These assets included a small flat in the seacoast city of Varna, one fourth of a flat in Sofia, and a garage. Dimitrov's main assets, including hotel Konstantin Palace, had already been allegedly laundered and sold by his widow prior to the launch of the investigation. She reportedly earned BGN 4 million (approximately $2,6 million), in exchange for the hotel, through front companies. While the authorities had difficulties establishing the real amount of all illegitimately gained assets and prevent the laundering and sale of these assets, Angelina Dimitrova had little trouble showing that she and her late husband had legitimately earned nearly half a million dollars between 1990 and 1999, including about $277.641 from potato production, financial support from Dimitrov's parents amounting to $30.000, income from a restaurant business and other trading activities and presents from friends.[213] While the sale of assets had likely involved wire transfers abroad, the potato production legend is not a sophisticated laundering technique that would involve international transactions and offshore corporate vehicles (*i.e.* the use of the advantages that globalisation offers). Dimitrov has declared profits from potato production and has probably duly paid profit tax.

What is the moral? One does not need to be cynical to see the irony in this story. Even after his death, Dimitrov managed to ridicule the authorities, while his widow continued to enjoy the fruits of the alleged crime. The story could have ended there, because as broad as it is, the application of the laundering definition is largely subject to convenient political choices. The continuation of the Dimitrov story demonstrates that, despite draconian laws and the broad laundering definition, (or because of it) the process of enforcing justice had been at fault somewhere along the line. Would Dimitrov's widow be allowed to remain in possession of the criminal heritage?

The size of the entire estate of Angelina Dimitrova remains a question. However, in appeal proceedings with regard to those assets that were to be confiscated, in 2008 the Supreme Appeal Court ruled, after all, that Angelina Dimitrova and her late husband could not have made their money (or not, at least, a substantial portion of it) through growing potatoes. Apparently, as the court revealed, they were not registered as agricultural producers at the time when they were supposed to be dealing in the potato business and were not

213 See Bulgarian media reports including Radoeva, *Monitor* of 30 November 2006, *Standard* of 30 November 2006, see also *Mediapool*, 7 December 2003.

able to produce documents to proof the purchase of potato seed or fertilisers.[214] As it appears, the Dimitrovs had not thought it through well enough.[215]

3.3.2. Different earners – different forms of conduct

It seems obvious that money laundering is required for large-scale earnings, although the law does not differentiate between 'large' and 'small' money laundering. In practice, there is a commonly accepted average threshold of €15.000 ($10.000 in the US[216]) by which financial transactions should be reported or be subject to customer due diligence as required by the Third EU Directive, unless, with smaller sums, the acting person behaves 'suspiciously'.[217] No explicit guidance has been given as to how and whether we should watch out only for large-scale criminal earners. As a matter of fact, small transactions also have to be scrutinised lest they might be a component in a 'smurfing chain'[218] in order to remain under the €15.000 threshold.

Hence, the proceeds from all sorts of crimes are categorised using a common denominator, regardless of the nature of crime, the volume of money and

214 See Bulgarian media reports, including *Dnevnik* of 10 August 2008.

215 Yet, it appears that in separate proceedings for alleged contraband activities and related laundering Angelina Dimitrova was acquitted in 2010. Reportedly the judge ruled that since the offence of contraband could not be proven, there was no money laundering, although the decision was apparently not final (see *Dnevnik*, 26 May 2010).

216 In some circumstances the requirements are more complicated. For instance, in the US, Money Services Businesses have to comply with two different dollar thresholds that require a SAR. As explained on the website of the US Internal Revenue Service, the thresholds depend on the stage of discovery and the type of transaction involved. A $2.000 threshold applies if a customer is conducting or attempting to conduct a transaction(s) that aggregates to $2.000 or more - the $2.000 front door rule for transactions which are face-to-face with the customer. A threshold of $5.000 applies for transactions identified by issuers of money orders or traveler's checks from a review of clearance records - the $5.000 back door rule which applies after the records have been processed at the issuer level, *i.e.* the back door (IRS website, last updated on 30 November 2010).

217 In the US any transaction in currency of $10.000 or more requires filing a Currency Transaction Report (CTR). Regardless of the amount, if there is suspicion that the money is the proceeds of crime or the customer is trying to avoid the BSA reporting requirements or in some other way is violating the law, a Suspicious Activity Report (SAR) has to be filed. In Europe, the Third EU Directive, article 22, states that Member States shall require the reporting institutions/persons to promptly inform the FIU where the institution knows, suspects or has reasonable grounds to suspect that the transaction is related to money laundering or terrorist financing. Article 7 states that the reporting institutions shall apply customer due diligence: (a) when establishing a business relationship; (b) when carrying out occasional transactions amounting to €15.000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked; (c) when there is a suspicion of money laundering or terrorist financing, regardless of any derogation, exemption or threshold; (d) when there are doubts about the veracity or adequacy of previously obtained identification data.

218 'Smurfing' is the practice of structuring a transaction into a series of transactions of smaller amounts in order to avoid regulatory and law enforcement scrutiny.

the characteristics of its earner. But it seems quite obvious that different categories of criminals have different goals, different laundering (or rather crime-money management) needs and different financial conduct. Different forms of financial conduct have different impacts on the economy (as discussed earlier). The unwanted effects of crime money and laundering are largely determined by the nature of the predicate crime and the related volume and 'colour' of the proceeds (which will be discussed in the next section).

The criminal activities of the 'usual suspects', *e.g.* drug dealers, the kind of offenders legislation has been historically aimed at, who usually have to deal with large quantities of quickly raised cash, generate different money laundering needs compared to criminal earners such as alleged money launderer Robert Maxwell (Reuter and Truman, 2005). High-cash business is often the easiest way for drug dealers to launder their money. However, Maxwell needed a more sophisticated and instant laundering vehicle for the money he reportedly siphoned off from the London pension fund of Maxwell Mirror Group Newspaper PLC in 1991.

Stripping off the assets of a bank bringing it to bankruptcy or siphoning off the money from a pension fund, can generate a massive profit exceeding several hundred million dollars. The perpetrators of such offences are not 'the usual suspects'. Rather, they are usually well educated and well connected people with insider knowledge and in a position of trust.[219] In order to instantly provide a legitimate appearance to their massive profits, such offenders would need to undertake an equally massive money laundering operation, either concurrently with the offence or subsequently. If not carried out well, the impact of such a money laundering operation would be distinctly visible, as in the case of Maxwell. On the contrary, the impact of money laundering undertaken by criminal gangs is less visible and more difficult to prove because it is spread over time. The activities of a gang are not limited to a single crime but include consistent perpetration of offences, each on a smaller scale. Additionally, a large proportion of the revenues of organised crime groups is usually being distributed between the numerous group members in portions too small to require the use of laundering techniques.

219 The profiles of the various offenders often reflect the laundering *modus operandi*. If these are the 'usual suspects', *i.e.* the kind of offenders legislation has been historically aimed at, they will be seeking to launder the money in an easy, simple way, for instance via cash-based business such as restaurants and pizzerias. If they are sophisticated offenders, their laundering schemes will be likely head and shoulder above the schemes applied by the 'usual suspects', simply because these sophisticated offenders are in a position of trust and have access to better resources in the upperworld.

The revenues of fraudsters can also be spread over time (*e.g.* VAT fraud), but these will be interwoven in their 'upperworld' business. In the case of elite crime 'high-fliers' such as Stanford and Madoff, the laundering activities are naturally spread over long periods of time, but that is mainly due to the fact that in such cases the predicate crime coincides with the laundering offence.

In some cases, where the scope and type of criminal activities require a large-scale money laundering operation and a high level of organisation, the flow of funds can move from the countries of origin to countries of investment, for instance from Russia to the UK, and return with a transformed, 'legitimate' appearance.

As previously discussed, where the criminal money earners do not wish to 'put their money to work', *e.g.* invest in a legitimate enterprise for instance through privatisation procedures, they may simply seek to move their funds to banks of high discretion, *e.g.* offshore (even if interest rates there are low).

Concealment of crime-money and large-scale laundering operations may necessitate cross-border transfers and offshore structures, while laundering, in the strict sense of the term, of smaller amounts of crime money can be done in a domestic context with no need for offshore accounts and shell firms. There is the broad category of smaller criminal earners whose activities are less, or not at all, international in scope and who do not need to take advantage of globalisation in order to launder their funds. In fact, even big criminal earners can generate and launder crime proceeds domestically, but need to pay attention to their 'financial space' in which they plan their laundering.

Allegedly, laundering in certain sectors is considered easy and a kind of natural aspect of the nature of the enterprise. However, this normally holds true under routine criminal controls and is aided by corruption. Public procurement schemes can be facilitated by corrupt officials, making obtaining evidence or even disclosure difficult. Property development is another sector, although the launderer cannot act alone: investing 'funny' or 'hot' money and keeping the books in order requires a 'pre-wash' and accountancy support. It is said that high cash businesses such as consumer product retailers, restaurants and catering services, gambling and betting, (where it is difficult to precisely check incoming and outgoing money flows), can all be used for money laundering. While this is true, it is in fact the business volume which determines the space for laundering. For example, the artificial increase of the turnover of a restaurant may appear easy, but without increase in profit there is no or little white money generated. Increasing the profit is not easy because an increase of turnover entails increasing expenses: staff and the buying of food and drink. Indeed, to launder in a businesslike fashion, one must be able to run a business properly. For this, few criminal earners have the required skill. As a matter of fact, as previously noted, in his research of crime-money management patterns in the Netherlands, Van Duyne (2003b) has found little empirical proof of sophisticated laundering schemes (but that concerns the 'usual suspects' as opposed to sophisticated 'elite crime' high-fliers). Analysing the laundering conduct of high-earners (€450.000 plus income) he arrived at the following results:

Table 2
Ways of disguising proceeds: number of observations

Forms of concealment/disguise	Drugs trade	Fraud and economy	Other crimes for profit	Total
Export	31	9	2	42
Ownership disguise	10	5	4	19
Justification				
• Loan back	3	3		6
• Payroll	2			2
• Speculation				
• Bookkeeping	7	4	2	13
'Untraceable'	4	8	2	14

As can be observed in the table, fraudulent bookkeeping occurred much less than simply exporting the money out of the country. It was also surprising that corporate criminals displayed much less effort to launder their crime-money inside their firm by means of fraudulent accounting. Most entrepreneurs simply took it out of their firm to spend it on the pleasures of life.

The point is that usually the scale of earning and the predicate crime are likely to determine the subsequent criminal financial management conduct of the criminal earner. But this is not an undimensional causal path dictated by the volume of crime-money only. To understand money management, one also has to understand the socio-economic culture in which this takes place. For example, a criminal earner of an ethnic non-integrated minority is more likely to export the money to his home country. The indigenous crime-entrepreneur has other ideas: unless he reinvests his money in a licit business, his money trails lead to an expensive lifestyle (*e.g.* expensive travels frequently documented by credit card payments). Therefore, the effect of criminal money management conduct on the economy and society as a whole can vary widely, naturally first of all by volume. One may wonder whether the manifestations should really be brought under one denominator.

The way money from large-scale economic crime is laundered sometimes mirrors serious ambitions, for example concerning the 'licit' firm which is also the source of the criminal income. This depends on how criminal earners project themselves in society. The 200 illegal cartel builders in the Dutch construction industry netted tens of millions euros and even established a separate firm only for clearing mutual claims and handling the related fraudulent documents, and thereby the laundering. This was, in effect, a high-level, high-earning organisation. However, apart from already having presumably a high licit salary (at least as far as the senior managers are concerned), the firms also kept the crime-money, thereby strengthening their economic and social position (Van Duyne *et al.*, 2005; Van Duyne and Van Dijck, 2007a). This type of crime-money earner should be targeted differently when compared to the lavish spenders or small earners who may not even need laundering in the strict sense of the term. Petty or 'mid-level' criminals can enjoy their crime-money by simply spending it on daily needs. Crime money can be blissfully enjoyed as long as it is not questioned (by the tax authorities, privatisation agencies, banks and so on). However, given the skewed distribution of criminal income, when all criminal earnings are categorised the same, it remains a question how successful and how valid this one size-fits-all approach is.

3.3.3. Differentiation between money from various crimes

Seriousness of predicate crimes and money laundering

Although money laundering is a consequential crime that depends on predicate crimes, according to criminal law, it is a separate offence with its own maximum penalty, not necessarily related to the maximum penalty of other offences. This means that the laundering consequences of a successful embezzlement, for example, may carry a higher sentence than the actual embezzlement. The question is whether this is the right approach.

When we consider the effects of crime-money and money laundering in terms of seriousness, we have to take into account the nature of the predicate crime and its seriousness. As discussed earlier, the seriousness of crime can often be subjective as it is largely based on value-based perceptions. Seriousness is a complex variable that reflects the relative weight of wrongfulness and harmfulness of an offence (O'Connell and Whelan, 1996). The assessment of crime seriousness is an important exercise as the degree of blameworthiness and harm determine the criminal blameworthiness and the potentially related punishment. There are various methods in evaluating and ranking the seriousness of crime, including public surveys of perceptions and statistical and monetary assessments based on measuring losses from crime and the expenses incurred by victims and so on. Results produced by different methodologies may differ to the extent that certain variables are taken into account or left out (see for instance Cohen, 1988). Moreover, while there may be a degree of uniformity in the average rankings, research shows that individual perceptions may also vary widely, thus challenging the general consensus of perceived crime seriousness (see Durham, 1988; Davis and Kemp, 1994; Kwan *et al.*, 2002; Paulin *et al.*, 2003).

Additionally, perceptions change over the years. For instance, for a long time criminologists believed that the public had little concern about white-collar crime until a series of high-profile cases appeared to have raised people's awareness (see Goff and Nason-Clark, 1989). Recent allegations of large-scale fraud schemes, specifically the Madoff and Stanford cases that shook the industry in 2008–09, have added to this feeling of seriousness. For many years now drug trafficking has been perceived as a serious crime and, as reviewed in previous chapters, the powerful war on drugs developed into a war on money laundering. Laundering became to be perceived almost as equally seriously as drug trafficking.

Policy makers have continuously sought to convince the public of the need to fight money laundering (as reviewed in the previous section) but little attention has been paid to the relationship between the seriousness of laundering and the varying degree of seriousness of the underlying criminal conduct, and to the way the various types of conduct should be treated. As reviewed earlier, there have been prosecutions on laundering charges for the simple act of cashing embezzled cheques or paying rent with tainted money. Yet it seems that professional launderers, the ones who are really deep into the laundering business (and perhaps, there are not so many of them around), somehow manage to stay out of sight of law enforcement and prosecutors. As soon as one wants to conceptualise a 'seriousness scale,' one realises that 'seriousness of laundering' is very composite and as artificially complex as the internationally adopted legal definition of laundering. The degree of seriousness of the laundering offence depends on the nature of the laundering activity, which produces a scale of its own. Laundering is such a broad concept covering a wide variety of conduct to which different degrees of blameworthiness can be attached. Furthermore, the degree of seriousness of laundering also depends on the dimension of seriousness of the predicate crime, as perceived.[220]

Firstly, there is the seriousness of the predicate crime (for profit) in terms of harm inflicted upon specific victims. But is this seriousness a good measure for determining the seriousness of laundering? There is no one size-fits-all relationship or any adequate way to compare and summarise/balance these relationships under a common denominator. For instance, stealing a painting by Van Gogh is not quite the same as stealing the precious family silver, irrespective of its monetary value.

Secondly, there is the scale of seriousness in terms of volume: tax fraud, which is always large in its aggregate form, may cause little or no harm to specific individuals but can be excessively harmful to the economy and society as a whole. In particular, 'not harming specific individuals' applies to *income* tax fraud. However, corporate tax or VAT fraud may be detrimental to other firms and reinvesting the crime money into the fraudster's own firm may push fellow entrepreneurs out of business.

Thirdly, there is also the consensual crime, like some forms of corruption (if it is not extortion), drugs trade and, to an extent, human smuggling,[221] which has a different degree of seriousness.

It is important to consider these aspects of seriousness within sentencing practices for laundering.[222] But unfortunately existing legislation and sentencing practices across countries do not necessarily reflect this need adequately. In the US, in the early 1990s, following mounting criticism from practitioners who asserted that a money laundering charge could result in a significantly higher guideline sentence than if the underlying offence alone was charged, the US Sentencing Commission determined that, indeed, the existing penalty structure did not accurately reflect offences' seriousness. For example, according to the Commission's findings, the money laundering offence level was higher than the underlying conduct's offence level in 52,5% percent of drug-related cases and in 96% percent of the non-drug cases (see US Sentencing Commission, 1995). An effort was made to improve the situation and amend the US Federal Sentencing Guidelines, §2S1.1. Laundering of Monetary Instruments; Engaging in Monetary Transactions in Property Derived from Unlawful Activity, which tie

220 There are two tendencies: (a) to connect the seriousness of laundering to the predicate crime, or (b) to give laundering an independent seriousness weight. It can have a higher maximum penalty than the predicate offence. In the Netherlands you can be convicted for laundering even if the underlying crime has remained unspecified.

221 As opposed to human trafficking which is not consensual.

222 Particularly with regard to 'self-laundering'.

offence levels for money laundering to the seriousness of the underlying criminal conduct.[223] However, such efforts to refine the way of determining the seriousness of the laundering offence are inconsistent across countries (or rather consistently unfruitful), despite the drive for globally universal anti-money laundering policies.[224] There have been some efforts to form a debate about this issue in Europe but these efforts remain fragmented as they are stalled by a bureaucratic and inflexible, at times almost stagnant, policy-making system that has been built over many years and is largely determined by political choices. In this regard an interesting observation was made during a debate of the UK House of Lords in December 2009 concerning the Report of the European Union Committee on Money laundering and the financing of terrorism. Lord Jopling, Chairman of the European Union Select Committee's Sub-Committee, noted that:

> "*given the immense burden of the regime on the private sector, we questioned whether the regime should apply where the underlying criminal offence is minor or even trivial. Some of our witnesses, especially the Law Society, agreed with us. We recommended that the Proceeds of Crime Act 2002 should be amended to exclude minor offences. The Government, in a response that I commend for its careful consideration of our recommendations and, to be fair, its full response to them, explained at length why an all-crimes approach should be retained. They pointed out that there may be little correlation between the sums laundered and the seriousness of an offence, that an activity may be suspicious irrespective of value and that something that the reporting institution may regard as trivial may look very different to SOCA when considered with other intelligence.*" (House of Lords debates, 2009, paragraph 7[225]).

Lord Jopling then expressed his disappointment that the Government could not accept the recommendation and noted that, if that should be the case, it is all the more important that the government consult more fully with the private sector and give more feedback on their work. And that, of course, as we know, largely remains wishful thinking.

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223 The guideline links the sentencing levels to the type of offence and the value of laundered money. For example, offence levels for theft are lower than for forcible extortion or drug trafficking. The guideline directs a court to increase the base offence level if the defendant knew or believed that the funds he has handled were proceeds of unlawful activity, or were intended to promote unlawful activity (see related cases United States of America v. Abdillah S. ABDI and United States of America v. Abdirahman Sheik-Ali Isse).

224 Harmonisation of anti-laundering policies appears to be limited to criminalisation, structural measures and investigative aspects but not sentencing. Besides, although significant progress has been made in terms of improving the exchange of information between financial intelligence units, there is still a lot to be achieved in this area.

225 Retrieved online, therefore no page number is available.

As elaborated earlier, national anti-money laundering regimes are still based on extensively broad concepts (but in international politics decision takers rest as soon as there is agreement on shared concept, even if it is loosely defined). This means that if we want to assess the seriousness of the underlying criminal conduct, there is a logical uncertainty about the seriousness of the laundering offence. The range of it can stretch from establishing a sophisticated laundering firm for false accounting (the Dutch cartel conspiracy, see Van Duyne and Van Dijck, 2007a) to letting your friends hide their crime money in your kitchen. The laundering aide might even be unaware of the exact nature of the predicate crime. He might think that the money was from tax evasion when in fact it was the premium for a contract killing. The undeterminable scope of application of the laundering concept, because it is severed from the predicate offences, may result in all kinds of absurd interpretations in legal practices. This demonstrates that this legal point of relating the consequential crime to the preceding crime has not been well scrutinised.

The 'colour' of crime money

Arguments of policy makers about the effects of crime money and money laundering create a real threat image (as discussed earlier) and are largely focused on the idea that any use of crime-money is evil. While by no means should we tolerate criminals enjoying the proceeds of their crimes, it is empirically wrong to put all crime-money under a common denominator (as argued in the previous section) as is usual in the official rhetoric. If we can describe metaphorically the monies from crimes with different degrees of seriousness as having different colours, the money from crimes perceived as more serious would be darker than the money from less serious crimes. Using the same metaphor, it seems that policy makers perceive almost all crime money as equally dark, with probably just drugs proceeds[226] ahead of all other moneys. For example, in the Netherlands sentencing is based on the seriousness of 'affecting the integrity of the financial system' which means that the consequence of the 'integrity dogma' is that no distinction is made between the various colours of crime money. But, as remarked, crimes for profit vary widely: from tax evasion and commercial fraud to drugs, human trafficking and the more exotic, art crime. However, the colour of the predicate crime and the cultural backgrounds of the perpetrator may still peep through in the sentencing for laundering but only to exhibit inadequacies. The young Turkish man who smug-

226 And lately also human trafficking.

gled €25.000 strapped to his body (drug related) received a prison sentence; the illegal cartel conspirators laundering tens of millions euros received a few weeks community service (see Nelemans, 2009).

The monies derived from the various predicate offences should logically have different nuances of 'taint' or 'colour' and different relationships to the act of laundering. Independent from that, the impact on society (as reviewed earlier) can economically and socially be different.[227] Furthermore, money laundering itself can be a source of proceeds for those who facilitate laundering or deal with it professionally. These proceeds need to be laundered too or –under the broad meaning– are laundered as soon as they are spent. By cooking the books, the mob's accountants, lawyers and bankers present the laundering transactions as legitimate while earning their fees for these services constitutes a derivative laundering act. If we compare the colour of their earnings with the earnings of their principals, the former would probably be less dark,[228] although policy makers seem to consider them just as dark. To make things slightly more complex, laundering the proceeds of laundering is the third degree derivative. But it does not automatically share the evilness of the predicate crime (unless the 'integrity dogma' is invoked).

If we accept the relevance of the relationship between the predicate crime and the consequential laundering act, then the nuance of crime money's colour should be 'measured' by the extent of the harm caused by the predicate offence, which means that the proceeds from the most 'serious' offences would be ink-black. The colour of the proceeds from less serious crimes would be less dark, probably greyish. Predictably, there is the question of what social values and interests deserve criminal law protection and how punishments should be valued as proportionate. There is no simple answer to these questions (see comments on evaluation methods above). Despite globalisation and the USA's aspiration to establish a universal order, national systems of social values and criminal law continue to vary in terms of substantive law as well as punishment.

As discussed previously, certain acts are not yet considered a crime in all jurisdictions, which has led to the emergence of 'jurisdiction shopping', a phenomenon facilitated by globalisation (see Passas, 2002). Criminals can share the same advantages of globalisation as legal business enterprises. The diversity between jurisdictions in their political, economic, cultural and law systems hampers the mobility of law enforcement efforts. Control systems have been seri-

227 These consequences may be different from the moral relationship to the 'colour'.

228 This is not always the case, because if 'cooking the books' makes the accountants effectively accomplices to the crime, it is just as reprehensible, thus having the same 'colour'.

ously challenged to detect and prevent cross-border crime under conditions of discrepancies in law enforcement resources and regulations across the borders. The existing asymmetries between countries have a criminogenic effect in that they create a unique incentive for criminal entrepreneurs to profit from cross-border transactions by taking advantage of these 'criminogenic asymmetries' (see Passas, 1998, 1999, 2002).

These asymmetries indicate that there is a certain degree of subjectivity in defining which acts cause harm and should be denounced as crimes. For example, abortion is legal in most countries, but in some, like Poland, it is illegal or subject to severe limitations (as mentioned previously). Where on the colour scale would we put the income earned by doctors who perform illicit abortion operations? While in some jurisdictions insider trading or cartel building are criminal offences, in others they are an administrative transgression. A range of acts that would constitute tax evasion, hence a serious predicate offence, in many countries, are treated as civil matters in Switzerland. Prostitution is another debatable crime. Even soft drug trade is not universally regarded as a serious crime. For instance, personal use of cannabis is largely tolerated in the Netherlands.[229]

The fact that certain acts have not been commonly denounced as (serious) crimes makes the assessment of taint nuances, particularly concerning sentencing, more difficult. 'Serious offences' vary widely and money-laundering laws generally do not acknowledge nuances of crime money's colour. In many countries drug trafficking, child pornography and large-scale tax evasion are considered to be serious crimes and are treated almost equally under anti-money laundering laws, despite the fact that the harm caused by these crimes is different in extent and nature. In other words, while the maximum penalty for the various predicate crimes varies (reflecting their extent of seriousness), the maximum penalty for laundering is the same, although it would make sense, summarising previous observations, if the maximum penalty for laundering was tied to the predicate offence as a proportion of, let us say, 2/3.

Child pornography should, no doubt, be defined as one of the most serious crimes by the gravity of harm it causes and the seriousness of offenders' culpability. In 2006, during public hearings held by the US House Committee on

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229 Since 1976, the Dutch law has distinguished between hard (*e.g.* heroin, cocaine and ecstasy) and soft (cannabis) drugs. The possession of a small amount (less than 30 grams) of cannabis for personal use is tolerated and carries only a minor punishment, if at all prosecuted (see *States News Service*, 10 July 2007).

Energy and Commerce[230] it was suggested that the business of sexually exploiting children was worth $20 billion a year (Brockman, *New York Times*, 2006). Provided this figure is accurate and not politically motivated, it follows that each year substantial proceeds from child pornography must require laundering. However, estimates of crime money flows, including from child pornography and sexual exploitation, vary and remain largely speculative and unreliable. Despite the inconclusiveness of such estimates, it seems that policy makers still single out illegal drug sales,[231] rather than child pornography or any other illicit activity, as the 'evil of evils'.[232] This may be because the illicit drug trade industry is allegedly worth significantly more than other crime-industries. Is the size of a specific crime industry the basis on which policy makers decide which crime is the biggest threat to society and therefore should be the top priority on their agenda? It seems that speculative figures are often used to justify specific policies but are not necessarily the actual reason for such policies. Otherwise, if the economic and financial weight of a crime was the basis for such ranking, policy makers should rank economic and elite crime higher than any other crime. There is consistent and international evidence that in terms of illegal profits economic or 'elite' crime rates much higher than those of the drug industry (Verhage and Ponsaers, 2009; Reuter and Truman, 2005). But economic crime has no threat image (it is no wonder that former Nasdaq[233] chairman Madoff, who is apparently less scary than any drug dealer, reportedly managed to mail more than $1 million in watches, diamond jewellery and other valuables to relatives and others despite being on bail[234]). It appears that policy making simply responds to images and political convenience, despite the ensuing inconsistency. And politically, policy makers get away with it.

The 'darkest' money

When we look at the foundations for assessing the darkest shade of money, we find much inconsistency. According to the UNODC World Drug Report of

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230 A standing committee of the US House of Representatives.

231 And perhaps lately also human trafficking which appears to be increasingly attracting public attention.

232 For instance, based on the 2009/2010 report of the UK Serious Organised Crime Agency (SOCA), previously cited (see section 3.2.3. of this thesis), it appears that SOCA prioritises its tasks with not much difference to the 1980s' realities and allocates the majority of its resources to drug-related offences.

233 Nasdaq is a US stock exchange market based in New York City. The acronym stands for 'National Association of Securities Dealers Automated Quotations.'

234 This matter received wide coverage. See for instance report by Bray published in *Dow Jones News Service* on 14 January 2009.

2007,[235] drug trafficking remains the single most profitable sector of transnational criminality (despite contrary reports concerning the profits from economic crime, particularly latest reports[236] on financial fraud).

Indeed, illicit drugs trade is a problem on a global scale. Germany is an example of how drug trafficking routes, originally defined by natural, geographical and social circumstances, share the opportunities of the globalisation processes.

> Dealers from Colombia, Bolivia, Peru and Brazil distribute cocaine in Germany. According to some estimates, nearly 90 % of the heroin market in Germany is controlled by Turkish groups who import opiates from Afghanistan, Iran and Pakistan (the 'golden half moon'), and Laos, Thailand and Myanmar ('golden triangle') into Turkey. From there (after turning the opiates into heroin) it is then transported to Germany through Bulgaria, Romania and Hungary. Asian groups operate in parallel with the Turkish dealers. The retail trade also involves black Africans (particularly from Nigeria). Hashish is being sold mainly by dealers from Morocco and Lebanon, but consumers also obtain hashish from the Netherlands. Synthetic drugs are offered by local dealers and dealers from the Netherlands and Poland, as the basic material for their production is available in Europe (see Suendorf, 2001; also Paoli, 2000; Fijnaut and Paoli, 2004).

This is just one of a range of examples relating to various countries that suggest a high level of pervasiveness of drug traffickers and an impressive international and financial scope of activities.

Do these facts and figures about the scope of illicit drug trafficking mean that it is the biggest threat to society; hence the laundering of its proceeds

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235 The World Drug Report of 2007 quotes the figures from 2005. The UNODC reports that the value of world illicit drugs trade is estimated at some $320 billion. The 2007 World Drug Report states that the value of illicit drugs trade is considerably greater than the value of trade in other major criminal commodities, for example $32 billion from global human trafficking (Belser, International Labour Organization, 2005; UNODC, 2007) or $1 billion from illicit firearms trade (Small Arms Survey, 2002; UNODC, 2007). An OECD 2004 report quotes the US National Intelligence Council's estimates that narcotics trafficking is worth $100-300 billion a year. According to the same report, other major illicit industries generate significantly less revenues. For instance, annual revenues from automobile theft (in the USA and Europe alone) are estimated at $9 billion; $7 billion from human smuggling and $1 billion from theft of intellectual property. According to UNODC 2010 report, the opiate market generates an annual turnover of up to $65 billion, of which some $55 billion for heroin alone (UNODC, 2010). As discussed previously, however, such figures are disputable. Needless to say one quotes the other and so 'truths' emerge.

236 Specifically, 2008 and 2009 media reports on large-scale financial irregularities and irresponsible conduct (if not criminal) that brought the markets to a credit crunch, and the Madoff and Stanford cases.

should be the top target (of all other proceeds from less 'evil' crimes) in the fight against laundering? Clearly drug addiction has a devastating effect as it feeds a culture that destroys families and society, *i.e.* it causes secondary harm to others. That is the common wisdom. Therefore policy makers claim that drugs trade has to be criminalised, reiterating arguments stretching back more than a century (Van Duyne and Levi, 2005).

However, if that has to be the case, this common wisdom should apply to a range of other goods and services, most of them licit.[237] Interestingly, consumers of illicitly traded cigarettes are not necessarily regarded as victims of crime, although they should be, considering the potentially dangerous contents of the counterfeit cigarettes.[238] The victims are the legitimate producers and traders who suffer from distorted competition (through counterfeit products), as well as states, which suffer losses as a result of the evasion of excise duty. Particularly in the case of cigarette smuggling, the authorities have highlighted the economic harm caused to the states as a result of substantial lost tax revenues.[239] The question here is whether policy makers rely on the fight against money laundering as a weapon against cigarette smuggling. In this respect an interesting case is the litigation involving the EU and several leading tobacco companies.

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237 Alcohol and gambling addiction also causes secondary harm to others but nevertheless alcohol and gambling are licit commodities and services. They are not perceived as 'the evil of evils' and their consumers are not regarded as victims. The role of diamonds in fuelling armed conflicts in parts of Africa has been recognised by the United Nations General Assembly. Yet diamonds are not a banned commodity either. Cigarettes also create a health damaging addiction, though its effect in the short-term is arguably not as dangerous as the effect of (some) drug consumption.

238 See Van Dijck, 2007b for analysis of potential links between cigarette smuggling and terrorism financing.

239 According to the Framework Convention Alliance, which serves as an umbrella for organisations working on the World Health Organisation's "Framework Convention on Tobacco Control", each year the illicit tobacco trade causes taxation losses of $33 billion globally (see report in *The Nation (Thailand)* of 23 March 2007).

The litigation comprised a series of civil actions beginning 2000.[240] In 2001, the EU filed a lawsuit in New York against Marlboro cigarettes producer, Philip Morris, accusing the company of collusion in tobacco smuggling to EU countries, particularly by intentionally oversupplying countries neighbouring the EU. It was also claimed, among other things, that Philip Morris facilitated and controlled smuggling activities by fixing prices on smuggled cigarettes throughout the world. The EU raised similar claims against several other tobacco companies, particularly RJR Nabisco (part of the R.J. Reynolds Tobacco group) and Japan Tobacco and their affiliated entities.[241] According to the complaint filed with the US District Court Eastern District of New York (Complaint European Community -v- RJR Nabisco *et al.*), the plaintiff accused the defendants of violations of the RICO statute arising from the "*defendants' involvement in organized crime in pursuit of a massive, ongoing smuggling scheme. Defendants have engaged in a pattern of racketeering activity, including but not limited to money laundering, wire fraud, mail fraud, and acts in violation of the Travel Act…*" (p. 3 of the complaint). The plaintiffs alleged that the defendants conspired with others to promote and conceal their smuggling activities and that in the process of smuggling cigarettes, the defendants engaged the services of drug traffickers and money launderers, thereby facilitating or engaging in money laundering. The defendants were also accused of repatriating proceeds "*through money laundering and other acts of concealment, all of which threaten the integrity of the United States financial system*" (p. 97 of the complaint). In February 2002 the lawsuit was dismissed with regard to the smuggling claims on the basis of the 'revenue

240 Plaintiffs began filing these lawsuits in 2000 under the RICO statute and subsequently the cases developed a complicated procedural history. Initially, the Departments of Colombia filed suit against Philip Morris, Brown & Williamson Tobacco Corporation, British American Tobacco South America Ltd., and their affiliated companies, see Department of Amazonas v. Philip Morris Companies, 186 F.Supp.2d 231, No. 00 Civ. 2881(NGG). Shortly thereafter, the European Community (EC, which later became EU), on behalf of itself, sued RJR Nabisco, Philip Morris, Japan Tobacco, British American Tobacco, Brown & Williamson, and their affiliates, see European Community v. RJR Nabisco, Inc., 134 F.Supp.2d 297, No. 00 Civ. 6617(NGG), and the action was consolidated with the Amazonas action. The district court subsequently deconsolidated the cases and dismissed the EC's lawsuit because the EC itself did not have standing under RICO, although it reserved decision on the defendants' motion to dismiss in the Amazonas case. See European Community v. RJR Nabisco, Inc., 150 F.Supp.2d 456, 459, 500-02 (E.D.N.Y.2001) ("European Community I"). In August 2001 the EC, this time with ten of its member states as co-plaintiffs, again filed suit against RJR Nabisco and Philip Morris, and the case was marked related to the still-pending Amazonas case. See European Community v. RJR Nabisco, Inc., 186 F.Supp.2d 231, No. 01 Civ. 5188(NGG).

241 In 1999 Japan Tobacco Inc. completed its acquisition of RJR Nabisco Holdings Corporation's non-US tobacco operations. In the lawsuit filed by the EU, Japan Tobacco was a defendant both individually and as a successor to R.J. Reynolds Tobacco International, Inc.

rule,'[242] a centuries-old common-law principle that prohibits foreign governments from collecting unpaid taxes through US courts. Although the plaintiffs' complaints did not distinguish between 'smuggling' and 'money laundering' claims alleging both types of conduct as predicate acts of racketeering under RICO, the district court treated them separately in its decision. As a result, while dismissing the smuggling claims with prejudice, the court dismissed the money laundering claims without prejudice. This allowed the EU to refile a new lawsuit, based on money laundering laws. In October 2002 the EU filed a suit against the R.J. Reynolds group of companies. The 149-page complaint outlines in detail allegations of R.J. Reynolds' involvement in corrupt business practices in Europe and Latin America, including dealings with members of the Italian Mafia and Russian organized crime groups, Colombian drug cartels and senior government officials in the Balkans, particularly Montenegro. In the meantime the plaintiffs also challenged the dismissal of the claims raised under the RICO statute, including by referring, on appeal, to the passing of the USA PATRIOT Act[243] of 2001, which amended RICO to include terrorism-related offenses as predicate acts. In their appeal the plaintiffs alleged a link between the smuggling activities, money laundering and the financing of terrorism. The dispute with Philip Morris dragged on until early 2004 when the company and the European Community, together with 10 EU Member States, signed a 12-year $1,25 billion agreement that includes the enforcement of measures against cigarette smuggling and counterfeiting. Philip Morris agreed to work with EU regulators and law enforcement authorities in the fight against contraband and trade in counterfeit cigarettes by implementing a better system of control over its supply chain, from manufacturing to the end consumer. According to a press report by Echikson published in *Wall Street Journal* on 6 April 2004, Philip Morris and EU representatives tried to avoid the word 'penalties' and said the payouts would be used to fight tax evasion. According to the same article, the

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242 There were several related cases. With regard to the action against Japan Tobacco and its affiliates, European Community v. Japan Tobacco, Inc., No. 02-7323 (2d Cir.), it was decided that the district court did not have jurisdiction over the complaint, as none of the defendants had been served at the time the district court dismissed the action on the merits. With regard to the other two actions, (i) the action filed by the European Community against RJR Nabisco, Inc., *et al.* and Phillip Morris International, *et al.*, (European Community v. RJR Nabisco, Inc.) No. 02-7330 (2d Cir.), and (ii) Department of Amazonas v. Philip Morris Companies, No. 02-7325 (2d Cir.), the court held that the smuggling claims are foreclosed by Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103 (2d Cir. 2001), cert. denied, 537 U.S. 1000 (2002), which held that the revenue rule bars a RICO suit brought by a foreign sovereign to enforce its tax laws.

243 The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism, Pub.L. No. 107-56, 115 Stat. 272.

deal did not affect the separate money-laundering lawsuit that was filed against R.J. Reynolds in 2002. Representatives of R.J. Reynolds told the press that the company had not had any discussions about settling the lawsuit and had no plans for settlement. Unlike R.J. Reynolds, it appears that Japan Tobacco International decided to follow Philip Morris' approach. In 2007 the media reported that Japan Tobacco International also agreed to pay the European Union $400 million in a deal to tackle the illicit trade in cigarettes in return for legal immunity.[244]

In view of the agreements reached between Philip Morris and Japan Tobacco, on the one hand, and the EU, on the other, it seems that the authorities are prepared to adopt a different approach – economic measures – to ensure that cigarette smuggling is contained. Whether the payouts will contain tainted money that can affect the integrity of the EU financial system is apparently not an issue. Neither is the harm that cigarettes cause to health. It is interesting, however, given the US drive to globalise efforts in the fight against money laundering, that this time the US judiciary made it so difficult for the EU to pursue its claims. Moreover, the 'revenue rule,' on the basis of which the smuggling claims were apparently dismissed, somehow contradicts the spirit of the US victory in the recent case against UBS (mentioned previously) where the bank was required to disclose the details of numerous accounts of its clients in Switzerland.

Policy makers preach that only a 'war' on drugs and related money laundering can effectively help root out the 'evil', although there is little evidence that aggressive law enforcement measures and penal approach can effectively uphold public health and solve social problems. The 2007 World Drug Report of the UNODC argues that "*drug control is working and the world drug problem is being contained*" (p. 1). Yet the report includes findings which contradict this statement.[245] Even a quick look at the price development versus the consumption prevalence makes clear that the war against drugs has not been particularly suc-

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244 See for accounts Weinstein and Levin, *Los Angeles Times*, 31 October 2002; Echikson, *The Wall Street Journal*, 6 April 2004; Bloomberg News, *Los Angeles Times*, 3 May 2005; Laitner, *Financial Times*, 14 December 2007; See also relevant EU press releases on http://europa.eu.

245 The report, for instance, notes that the success in the reduction of coca cultivation between 2000 and 2006 did not lead to a decline in cocaine production. Furthermore, the report admits that "*the most alarming trend with regard to cocaine has been its rapid rise in Europe over the last few years*" (p. 90). The United Kingdom, despite its robust regime against illicit drugs trade and money laundering, has the highest cocaine prevalence rates in Europe, after Spain. The 2008 World Drug Report of the UNODC states that *"[o]n the demand side, despite an apparent increase in the absolute number of cannabis, cocaine and opiates users, annual prevalence levels have remained stable in all drug markets*" (p. 7).

cessful.[246] Given these contradictory messages, it appears inapt to determine any kind of rank-order of 'darkness' based on the underlying findings presented in such reports because these findings can be manipulated and subjectively presented.[247]

Nowadays it is basically a matter of common belief that drugs are evil. Drugs are demonised and anything related to them shares this demonisation (including drug money, the pitiful mules and the pathetic junkies in the street). All arguments on this matter constitute some kind of anti-drug theology in which facts and research will only have a place on the policy making agenda if they support policy makers' objectives. Fact-based counter arguments are neglected. It is, for example, largely ignored that the element of free-will victimisation that thrives on self-indulgent pleasure-seeking is largely present in the drugs business,[248] the same way it is present in the gambling, alcohol and cigarette businesses.[249]

As Clarkson (1998) argues, the criminalisation of a type of certain conduct is justified if it presents an instrument for effective and necessary counter-acting of this conduct. There is no convincing evidence that the warfare concept in

246 Since 1986 the prices of most drugs have declined. Since 1990 the street prices for opiates have gone down from €200 to €54 per gram. Those of cocaine went from €135 to €70 per gram (UNODC, World Drug Report, 2007). As noted earlier, this trend has continued in the past two decades to a varying de-gree, depending on the type of drugs and the region (see UNODC, 2010).

247 The augmented FATF figures are an example of how research findings can be moulded into a shape that conveniently fits policy-makers' objectives (see Van Duyne and Levi, 2005).

248 This aspect seems to be overlooked by policy makers whose attention is largely focused on the supply side. The war on drugs is based on the belief that if supply is eliminated, there will be no drugs consumption. However, Polish 'kompot' demonstrates how demand can be self-sufficient (see Krajewski, 2000). 'Kompot' or 'Polish heroin', the production technology for which was developed by a chemistry student from Gdansk in the early 1970s, could be easily produced in an ordinary kitchen. It was distributed by addicts to other addicts as a matter of personal favour. After 1989 a growing tendancy for commercialisation of the drug distribution was observed: drug related activities became increasingly profit oriented (Krajewski, 2000).

249 At the same time, those at the far end of the supply chain are often farmers living in deprived areas. Some of them have little choice and practically no other means to sustain their living but through poppy and coca cultivation (although we should also bear in mind that synthetic drug operators produce in affluent countries for other affluent countries driven by the very same customers' self-indulgent pleasure-seeking). The UNODC admits that: "*The general political context also shapes drug supply. Drug cultivation thrives on instability, corruption and poor governance. The world's biggest drug producing centres are in regions beyond the control of the central government, like South Afghanistan, South-West Colombia and East Myanmar. Until government control, democracy and the rule of law are restored, these regions will remain nests of insurgency and drug production - and represent the biggest challenge to containment*" (UNODC, World Drug Report, 2007). Moreover, the UNODC 2010 report (p. 4) states: "*In the past decade, drug control has matured. Policy has become more responsive to the needs of those most seriously affected, along the whole chain of the drug industry – from poor farmers who cultivate it, to desperate addicts who consume it [. . .]. Slowly, people are starting to realize that drug addicts should be sent to treatment, not to jail.*"

rooting out drug trafficking has worked since it started a century ago and there is a strong opinion among researchers that policies should be reconsidered.[250] There are inconsistencies and discrepancies at a macro level as well as at case level, including in sentencing practices. As illustrated in previous chapters, while in some cases one may receive a disproportionately significant punishment for merely providing a safe place for friends' proceeds, in other cases money laundering charges appear to let 'Mr Big' get away with a relatively much less punitive response.

The war against 'the worst evil of all evils', drugs trade, as previously noted, has been extended into a war against money laundering. The latter, both at micro level and at macro level (as the various drug reports discussed above seem to demonstrate), appears to achieve little in terms of rooting out the drugs trade and drug related crimes. But unabatedly the war against money laundering appears to be used as a new universal remedy against all kinds of crimes, serious and less serious, creating a lethargic state of pleasant but illusory satisfaction that at least something is being achieved. If little is achieved, it means the threat is still there and more efforts should be deployed in order to curb it.

Less stained or just as dark? Economic crime and corruption

Unlike the illicit drugs trade, crime against property causes direct harm and the element of free-will victimisation is absent. Yet we tend to view the colour of proceeds from drugs trade as darker. Historically, under US pressure, drug related offences were the first crime to be named as predicate to money laundering, even though other acts were recognised as crimes long before drug related offences. The recognition of theft, for instance, as a public wrong, certainly preceded the criminalisation of drug trafficking. Of course, other kinds of profit oriented crimes, from alcohol smuggling to bank robberies, had become the common target of prosecution long before the criminalisation of drug trafficking. However, it appears that for political and fiscal reasons, as discussed in previous chapters, it was the war on drugs that turned the normal law enforcement

250 In 2009 Professor Nut was sacked from his position as the chairman of the anti-drug policy advisory committee of the British government after expressing his view, based on extensive research, that approach to at least some drugs, such as cannabis, should be reconsidered. Following his dismissal, several of the committee members resigned in support of Professor Nut. The media reported that an earlier attempt to draw the attention of the government to the possibility of declassification of some drugs had also failed (see reports by Lydall, *The Evening Standard*, 2 November 2009; Jenkins, *The Evening Standard*, 3 November 2009).

activity into an intense 'war on crime money and money laundering'.[251] Being proclaimed an immediate threat, drug trafficking had therefore to be addressed with full force.

Speaking in terms of volumes, it has already been indicated previously that the financial magnitude of corruption and elite crime, with its economic and social impact on society, may well surpass every other type of crime. Nevertheless, as observed before, for a long time money laundering has been more frequently associated with 'usual suspect' crimes: drug trafficking and other forms of 'traditional' crimes for profit such as human trafficking, rather than with elite crime, such as the theft of public property or inter-corporate bribery (Levi, 2001).[252] It took some time before fraudsters and white-collar criminals, such as the management of Enron, were concurrently prosecuted for laundering.

Worldwide, the history of financial fraud has a long record, one major example from the 1990s is the French bank Credit Lyonnais, which attracted significant controversy as a result of alleged illegal deals such as the purchase of insurance company Executive Life, embezzlement and lack of accountability (see McClintick, *Forbes*, 13 December 1999). However, it seems that in the US only the Enron and Worldcom scandals in the early 2000s put corporate crime and financial fraud more firmly on the political agenda (partly because too many US pensioners were affected). Similarly, in Western Europe, policy makers' awareness of fraud rose in the early 1980s following a series of "*scandals and increasing budgetary deficits, which plagued many countries*" (Van Duyne *et al.*, 2003a, p. 11). Germany, perhaps being one of the first to recognise the real effects of fraud on fair trade and income distribution, adopted in 1976 the First Law to Combat Economic Crime, which had a particular focus on deceit, loan sharking and bankruptcy fraud. However, even these progressive developments in Germany seemed insufficient to prevent and reduce fraud (Van Duyne *et al.*, 2003a). It is telling that in Germany, as in many other countries, economic crime is usually not subsumed under the denominator of the 'usual suspect' organised crime activities, which are then of course considered as more serious.

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251 As previously noted, although the first published use of the term 'money laundering' dates back to the Watergate scandal in the early 1970s, it became urgent for the US Government to use the criminalisation of money laundering as a 'justified cause' only in the era of the cocaine boom in the 1980s. The immense flows of money generated by the illegal drug trade could have motivated any government, not only of the USA, to declare 'war on money laundering' as a continuation of the 'war on drugs'.

252 We are currently observing a trend of the US authorities seeking to expand the reach and enforcement of the Foreign Corrupt Practices Act (introduced in 1977) which may lead to a higher number of money laundering charges related to elite crime and corruption.

Particularly in the field of economic crime we meet various unsolved questions related to laundering; one of the most interesting relating to illegal savings. This can be seen in, for example, environmental crime. The Naples pollution scandal[253] raises the question what the laundering relates to in a situation where, for example, €50.000 in expenses is saved by dumping the waste in the fields instead of delivering it to the legal waste site or the processing plant. According to the Strasbourg Convention, the matter is clear: illegal savings are an economic advantage from criminal offences and are therefore to be considered 'proceeds'.

Corruption is another crime with a long record but, as in the case with fraud, it took some time before policy makers undertook a more decisive action. During the Cold War little attention was paid to corruption in the international setting: it could be argued that a corrupt regime could expect support from the Western powers and reputable international organisations as long as it remained staunchly anti-communist.[254] In the 1990s – after the fall of the Wall – the situation began to gradually change and corruption became to be recognised as a global problem. Notably, the anti-corruption 'war' enfolded in the 1990s when the US, in pursuing its long-term objective of world dominance, no longer had the convenient justification of fighting the communist threat to uphold its policies. And again, notably, the 'war' began to mainly target bribery of foreign officials (this subject will be discussed in section 4.4.3.). At last, the 1997 OECD Convention Against Bribery of Foreign Public Officials in International Business Transactions,[255] (which came into effect on 15 February 1999), criminalised the offering, promising and giving of a bribe to a foreign public official in order to obtain or retain international business deals. How-

253 The problem was covered by the press in Italy and internationally (see report by Hooper in the *Guardian*, 3 June 2008).

254 Examples of such developments appear to be well documented. A report by AFRODAD (2005) notes that "*During the Cold War era the US government and its European partners rewarded a number of African nations (e.g. Zaire and Malawi) for being allies or for saying they were against communism. But the authoritarian regimes in these African countries did not care about economic growth. They just looted their countries and destroyed any economic potential for their people*" (p. 19). For instance, among those lending to "*the corrupt regime*" (p. 10) of Mobuto of Zaire (now Democratic Republic of the Congo) the report mentions the IMF and the World Bank: "*The IMF and the World Bank were also used as instruments in servicing American policy and geostrategy during the Cold War in that they rewarded Mobutu for his fight against communism in Central Africa especially Angola and Chad*" (p. 26). Some analysts have also noted that the IMF and the World Bank provided economic aid to Samuel Doe's regime in Liberia and other countries "*on the basis of perceived belief that a country was toeing a capitalist line, and not on the basis of sound economic policies or genuine democratisation principles*" (first paragraph of an online retrieved article, *Newvision.co.ug*, 2005).

255 These developments were largely driven by the US, which introduced its Foreign Corrupt Practices Act in 1977.

ever, little has been done to effectively tackle domestic political corruption such as illegal party financing and corrupt lobbying practices. Efforts in that respect have been half-hearted, to say the least, and undermined by the use of double standards.

It appears that although corruption money is just as dark, or even darker than drug money, the main anti-money laundering driving force, the US, vacillates and other countries follow suit. As Prevenslik-Takeda notes in her 2003 report on the status of the UN Convention against Corruption (which entered into force on 14 December 2005, becoming the first global legally binding anti-corruption agreement), the final consensus was achieved at the expense of the convention's effectiveness. Particularly problematic were clauses on political party financing, the non-mandatory provisions on most offences under the criminalisation chapter including bribery in the private sector, and the Convention's monitoring mechanism. Following a last minute ultimatum by the US, tacitly supported by China, Japan and Singapore, the original article 10 'Funding of Political Parties' was replaced by a weak optional provision. It appears that the authorities have always been less concerned about proceeds from domestic corruption than about proceeds from drug trafficking.

Corruption has different forms and while petty corruption may indeed be perceived as less serious than drug trafficking, grand corrupt practices are usually more sinister than we can imagine. The link to money laundering is also more significant and menacing, albeit often understated, than we normally imagine. As previously noted, the concept of proceeds from corruption, including corrupt party financing, is an interesting one. Where does the laundering start and end? Winning a government contract, being elected as a member of parliament or appointed to an executive post by paying bribes and using proceeds from corruption – these transgressions may constitute a crime in itself, but they can also be viewed as laundering. Is using the subsequent proceeds, for example, salary, to pay living expenses, laundering too? There is a problematic relationship with laundering in cases where corruption does not consist of monetary bribes, but favours such as helping a political friend's son with a job or meting out an unusual lenient sentence in return for another monetary favour. What exactly is being 'laundered' is unclear, even though there is clearly an illegal advantage?[256]

256 The investigation into alleged corrupt practices involving Jacque Chirac while he was mayor of Paris (see report by Willsher in the *Guardian*, 18 December 2009) is an interesting case: reportedly, the money of the city was being used to pay salaries to party supporters for meaningless jobs. There are illegal advantages, but what are the proceeds and where is the laundering?

In any event, the question remains how much can be achieved when there is little political will to fight corruption. In Transparency International's 2003 Global Corruption Report, Peter Eigen, the then chairman of Transparency International, noted that in the majority of the OECD member countries the political will to prosecute major bribery cases is lacking.[257] As long as corruption prevails, efforts to fight economic crime and money laundering will render little results. If tax evasion and laundering practices have been widely spread in Russia, it is largely because the phenomenon has been for a long time condoned and even facilitated by corrupt officials inside banks and the supervisory authorities (see for instance Kosals and Ryvkina report on Russia's shadow economy, 2002). Things began to change gradually during the 2000s when some government officials chose a different path to corruption. In 2006 Andrey Kozlov, head of bank supervision at Russia's Central Bank, who was overseeing the withdrawal of licences from banks accused of laundering, was murdered. Media reports suggested that he was targeted for his efforts to clean up the industry (see for instance *BBC* report of 14 September 2006). It appears, indeed, that Kozlov posed a threat to highly-placed interests. Informal interviews with bank industry specialists reveal that in Russia, during the 1990s, over 400 banks[258] were established for the sole purpose of facilitating tax evasion and money laundering. Since the early 2000s the number has decreased by nearly fifty percent due to enhanced financial controls and efforts (perhaps still, to an extent, selective and fragmented) to crack down on corruption.

Corruption is a fence for crime profiteering. It can even eliminate the need for laundering as long as it keeps all predicate crimes insulated from exposure. One could argue that politically motivated fabricated intelligence that serves to

257 Matters become more complicated if to the outright corruption we add crime or unethical behaviour (this further blurs the line) that is condoned (if not facilitated) by the state as were the financial pyramids in Albania during the 1990s. Elbirt (1997), who headed the Resident Office of the World Bank (WB) in Tirana at the time, notes that the WB warned Albania and advised to outlaw the pyramids. Yet their advice was not only ignored but Albanian officials were often seen in the company of pyramid masterminds at public venues. The Central Bank governor urged the Cabinet and then President Berisha to prohibit pyramid entities from collecting deposits. The Central Bank suggested as grounds for doing so that, according to the banking law, deposit collection is an activity that can only be carried out by licensed banks. The pyramids had no licence. Towards the end of 1996, however, judges appointed by the president ruled that the funds collected by the pyramids constituted bilateral loans, and were therefore not subject to the banking law but the civil code. In other words, the judges found an excuse not to outlaw the pyramids. The lack of will on the part of the government and the judiciary to take any action against the pyramids appeared evident.

258 This figure indeed can be disputed but, without a doubt, the wide-spread tax evading schemes and what became known as *obnalichivaniye* (see Kosals and Ryvkina, 2002) in Russia needed, at the very least, the tacit support of a horde of bankers and corrupt officials.

justify wars in oil-rich countries or countries perceived to have hostile regimes is also a form of grand corruption and fraud. Unfortunately, at least at this stage, there is still little political will to challenge corrupt practices. Yet, with regard to drug trafficking, policy makers are prepared to go the extra mile and fight a war. In an ideal penal law system one would like to have a system of severity rankorder of predicate crimes, which would then be reflected in the appreciation of the related laundering as a consequential offence. However, while clear yardsticks for such a rankorder are missing, political preferences and choices prevail. Therefore it is little surprising that it appears that there is a lot of arbitrariness in the use of anti-money laundering laws as an instrument to fight crime for profit.

This state of affairs results in a disorderly colour spectrum. While the US sentencing guidelines appear to recognise the 'colour of crime money' idea, FATF's central (and almost metaphysical) dogma about preserving the 'integrity of the financial system' counters it and allows no fluctuation in the shade of the colour. That said, in law enforcement investigations, prosecution and sentencing practices around the world some offenders are distinguished from others nevertheless, but without an adequate assessment system or yardstick.

4. Money laundering, transition and globalisation

Existing literature on money laundering as well as the common view in the regulated sector appear to show signs of bias towards developing and emerging markets by associating them with a higher risk of money laundering. This assumption is largely based on the belief that developing countries and countries in transition are plagued by a hidden economy and corruption. It is also based on serious doubts about the presence of 'good'[259] governance. Is that assumption correct? This chapter will look into the logic behind such a presumption and into the impact that the process of globalisation, in the form of integration of the transition societies into the 'old' capitalist world, has had with regards to money laundering activities.

4.1. Opening the borders: opening the floodgates?

In this section we will review the situation prior to the opening of the borders of the Eastern socialist bloc, the roots of crime and the alleged incentives of state security services to get involved in crime for profit during those years. We will also examine the link between opening the borders and the subsequent capital flight that may relate to 'laundering' activities and discuss what the application of this broad label entails. But first the criminal (and crime-money) situation before 1989 will be reviewed.

4.1.1. The situation prior to opening the borders

Criminal entrepreneurship in the region

The fall of the Iron Curtain in the late 1980s marked a change in the geopolitical and economic ideology landscape in Europe. The former socialist countries began liberalising their markets creating investment opportunities for international capital. Opening the borders, however, entailed that along with exposure to international capital, technologies and know-how, the transition economies

259 Good governance includes more than just democratic governance: it encompasses also the idea of the 'rule of law'. Italy is a democracy, but there are reasons to doubt the proper serving of law there given the cases of parlamentarians and government officials, including Prime Minister Silvio Berlusconi, coming under scrutiny over allegations of corruption. In 2010 the Rome-based state audit court reported that cases of corruption increased by 229% percent in 2009 from 2008 (report by Alimenti *et al.*, *Reuters*, 2010).

were at risk of absorbing also the Western world's objectionable elements such as criminal phenomena that could thrive presumably only in market economies.[260] Cross-border crime, such as drug and cigarettes smuggling, human trafficking and other (serious) crimes became a topical issue in the former socialist countries. Krajewski (2000), for instance, notes that while, during the socialist regime, Poland suffered from a drug culture (consumption of the home made Polish kompot mentioned earlier), the opening of the borders turned this drug culture into a profit oriented business and brought in the phenomenon of cross-border drug criminality. Crime grew rapidly across the whole former socialist block (see Joutsen, 2000; also for country reports on the Czech Republic and Ukraine, see Scheinost, 2000, and Osyka, 2000, respectively). The capitalist sun cast deep shadows.

However, there is also evidence that profit-oriented crime was not an entirely new phenomenon in the former socialist countries. As Joutsen notes (2000), what became recognised as organised crime in Central and Eastern Europe in fact took root in corruption and 'the shadow economy' of the preceding socialist society.

There is evidence that criminal entrepreneurship actually existed during the socialist era but it was associated with violence on a significantly smaller scale (certainly not as evident as during the wild times in Chicago or the East End of London, and even the so-called 'thieves in law' in Russia would not take their guns out in the Red Square to execute rivals) and was often closely intertwined with the political elite (see Rawlison, 1996; Friedman, 2000; Dimitrova, 2005), and probably for these reasons it was also less visible. There was theft, there was embezzlement, there was also some form of goods and human smuggling.[261] Some of these crimes involved cross-border activities, as the following case illustrates:

> In 1965 Eduard Kurtenkov was employed at the diamond-manufacturing factory Crystal in Smolensk, Russia. Almost immediately he began stealing diamonds. At the early stages of his illegal dealings Kurtenkov used an intermediary, Eduard Alexandrov, for clients in Moscow. Having learned a

[260] These criminal elements did not stem only from the 'usual suspects' crimes, such as drugs related crimes, but also from the greed of multinational corporations (see Markovska, 2007, for an account of pharmaceutical western firms penetrating the Ukrainian market).

[261] Reportedly during the 1960s and 1970s, when emigration from the Soviet Union was strictly controlled and considered as a betrayal to the homeland, many Jews attempted to cross the border illegally (which until the fall of the Wall was largely considered an act of liberation but subsequently became relabelled as human smuggling). Some of them were later prosecuted (see Kuznetsov, 2004).

few lessons from Alexandrov, Kurtenkov began dealing with Moscow clients directly. In Moscow Kurtenkov met Alexandra Kristensen, who was fictitiously married to a Finn and had contacts with foreign visitors in Moscow. Kurtenkov began selling diamonds to her, which she in turn sold on to foreigners. A frequent buyer was a national of Yugoslavia, who smuggled the diamonds to Berlin, hiding them in his mouth. In Berlin he sold them; with the profit he purchased a special material used in Tashkent to sew robes. The fabric was then sold to illegal sewing workshops in Tashkent through another accomplice known as Musaidov. Investigators were alerted by border control that Kristensen regularly received shipments of this material at Moscow Sheremyyetevo airport. The scam involved not only diamond smuggling and illegal tailoring shops but also illegal foreign exchange operations. The ring was busted on the eve of the 1980 Moscow Olympic Games, when about 50 people were arrested as part of a wider operation to cleanse Moscow of criminal elements.[262]

Similar schemes existed also in other sectors of the economy where there was an opportunity for profiteering (laundering, as a legal concept, did not exist yet in these countries). These schemes were part of the 'shadow economy'. But this 'shadow economy' included not only trade in stolen or illicit goods but also other transactions that otherwise would have been legal and ethical if not privately conducted. The economy was largely monopolised by the state and revenues were supposed to flow into the state budget, not into private pockets.

Some of the shadow economic transactions were driven by the lack of specific goods, which otherwise were legally available in the Western world. Scheinost notes (2000, p. 38):

"*Under the conditions of a state managed 'deficit economy', the shadow economy took the form of a system of mutual exchanges and scarce goods and services, which were available only to some privileged professions ('networks of mutual favours'). These exchange relationships involved usually the abuse of state property for professional purposes. This phenomenon was very common and widespread, but it still concerned mainly minor offences, though some succeeded in amassing a substantial, undeclared wealth.*"

The totalitarian regime managed to restrain, to an extent, domestic (mainly violent and street) crime. However, there were sufficient criminal minds who were prepared to engage in sinister activities. They needed to expand interna-

262 The case study is based on a documentary, "The Diamond Web", forecasted on Lubyanka show on the Russian TV channel *ORT* on 30 January 2005.

tionally in order to take advantage of the market economies outside the socialist block.

The international element

a. *The Mob*

Criminals from the former socialist countries had begun to form their international webs long before the collapse of the socialist regime and the opening of the borders.

When, in the early 1970s, Soviet leader Leonid Brezhnev allowed the limited emigration of Soviet Jews, reportedly thousands of hard-core criminals (either of Jewish status or who claimed to be of Jewish decent) immigrated to the US where they resumed their criminal activities (Friedman, 2000).

Many controversial figures, who emigrated alongside honest Soviet Jews, apparently worked with state security and intelligence agents from the socialist block and were better placed than anyone else to take advantage of globalisation. For instance, Smillie *et al.* (2000) describes how the Russian-born Shabtai Kalmanovich, who was believed to be a Soviet spy (see also Vaknin, 2002), established his presence in Freetown in Sierra Leone in the second half of the 1980s and used Sierra Leone to allegedly circumvent the weapons, diamonds and gold embargoes on South Africa. Reportedly, Kalmanovich not only smuggled diamonds and laundered money[263] himself but also brought in other money launderers and dealers to Sierra Leone. For example, Marat Balagula, an alleged kingpin of the Russian mafia in New York, was one of Kalmanovich's associates in Sierra Leone (Smillie *et al.*, 2000; see also Friedman, 2000).

Research suggests (see below) that in some respects socialist state security services operated in a similar way to the Mob and engaged in international activities which the West qualified as criminal. It would probably be fair to say that one of the most frequent targets of allegations and criticism has been the Bulgarian former State Security Service, DS (which stands for *Durzhavna Sigurnost*,[264] see below), alleged to have been involved in international drug trafficking (see Sterling, 1994; Adamoli *et al.*, 1998; Douglass, 1990; Krajewski, 2000; Passas, 2002; Manolova, 2002; Dimitrova, 2005), although the secret services of other states, for instance the former Yugoslav secret services, were similarly active (see Logonder, 2008). For example, the notorious Arkan was apparently allowed to commit crimes, such as bank robbery, abroad and, it was alleged, he

263 Laundering was not yet internationally criminalised but the anti-laundering campaign was gradually developing with the introduction of the Vienna Convention in 1988.

264 *Durzhavna Sigurnost* translates as 'state security'.

was supported by the Yugoslav secret services in his escape from a Dutch prison. Obviously, a considerable amount of crime-money was involved in these transactions (and some of these included the use of laundering techniques).[265] However, over the years this matter became highly politicised and, what was apparently state profit-oriented crime, came to be viewed in the West as an ideological Communist-led war against democratic Western states.

b. *State security services: the case of the Bulgarian DS*

In his book, "Red Cocaine: The Drugging of America and the West", Joseph D. Douglass (1990) suggests that there was a global communist conspiracy, led by the Soviets and China, to establish control over society globally through spreading and controlling drug sale and consumption. This echoed an older allegation raised by one of the most prominent former officials of the US Federal Bureau of Narcotics, Harry Anslinger[266] (also known as the 'Drug Tsar'), who during the 1950s, in the Cold War era, accused 'Red China' of undermining the West by making it drug-dependent (see Bewley-Taylor, 2002, 2002a).

Former Bulgarian spy, Colonel Stefan Sverdlev, who defected in 1970, claimed that in 1967, during a meeting in Moscow, the secret services of all member countries of the Warsaw Treaty agreed on a plan aimed at destabilising the West through various means, including control of the drugs trade (Dimitrova, 2005). Bulgaria was chosen as a strategic transit point because of its geographical location. A Bulgarian state export-import company called Kintex[267] (Dimitrova, 2005; see also Douglass, 1990; Sterling, 1994; Passas, 2002; Manolova, 2002), registered in 1966, was to play an important role in the drugs trade and other special operations of the previously mentioned Bulgarian State Security Service or *Durzhavna Sigurnost*, DS, including crime-money management involving laundering techniques.[268] According to Sverdlev, Turkish drug

265 As a native Bulgarian, the author of this thesis has access to original media sources and academic research materials in Bulgarian language and has therefore focused on the Bulgarian DS.

266 He was first Commissioner of the Treasury Department's Federal Bureau of Narcotics (FBN) from 1930 to 1962.

267 There have been numerous press reports, both in Bulgaria and internationally, on Kintex's alleged involvement in the illicit trafficking of goods, drugs and arms.

268 Bulgarian government Resolution N 148 (dated 31 July 1978) envisaged that Kintex controlled the hidden transit trade involving goods traded under special international trade regimes; transactions in monetary instruments and securities; as well as goods of special or high value, but for which the clients-deliverers had no official permission to transit through neighbouring countries or to import into the country of final destination (see Manolova, 2002). The document appears to have given the go-ahead to transactions that circumvented international trade regimes to ensure economic benefits. However, this would hardly explain the conspiracy theory regarding sabotaging the West.

dealers and DS agents could often be seen in hotel Vitosha in Sofia. DS agents allegedly helped Turkish dealers[269] to pass drugs onto dealers in Western Europe and the USA.[270]

This repeatedly exposed alleged conduct, on the part of not only DS but secret services in general, was more likely to have been driven by the need to pump in slush funds, *i.e.* a desperate need for unaccounted money, rather than any ideological beliefs[271] (as long as we understand that ideology is often misused as a tool to enforce power and influence).

Security services have the capability of carrying out complex operations in a highly clandestine manner using undercover agents and shifting money across the world. Besides, no doubt, security services do need to maintain connections to the criminal world as this may be necessary for certain risky operations (see for instance Logonder, 2008, for an account of the Yugoslav secret services' activities). That is the nature of their work and part of their intelligence gathering effort. However, when these connections are used to illicitly generate money (or strengthen the belief that crime is on the increase and therefore any counter-activities should be deemed as justified), then clearly the problem is that state agencies abuse the system.

US agencies (specifically the CIA, as reviewed earlier), have also been accused of involvement in drug trafficking (see Van Duyne and Levi, 2005, for a detailed account of drug trafficking history in Europe and further afield). Allegations about the US secret services using drug money to fund covert operations against unfriendly governments and insurgent groups, including communists (see Lifschultz, 1988 and 1992; Scott, 1992; Van Duyne and Levi, 2005) or the French intelligence services resorting to opium resources to fund its war operations against Vietnamese nationalist insurgents (during the Franco-Vietnamese war) (McCoy, 1972/2003; Lewis, 1985; Van Duyne and Levi,

269 The role of Turkish dealers, for instance, would hardly be consistent with the conspiracy theory that the socialist block wanted to sabotage the West through global drug control.

270 CIA's former deputy director for intelligence Dr Ray S. Cline notes that Bulgaria was a 'strange case' and that the CIA had identified it as the new centre for directing narcotics and arms trafficking between Europe and the Near East (Douglass, 1990). In 1984 John Lawn, DEA's then deputy administrator, testified to a congressional committee that starting from 1970 Kintex had sold heroin and morphine base to European traffickers as well as guns throughout the Middle East (Shinkle, 2003). For that reason the DEA severed cooperation with Bulgaria and resumed it at the start of the market reforms in 1989 (Shinkle, 2003).

271 Dimitrova (2005) quotes an anonymous source, a former Bulgarian intelligence officer, according to whom there were no 'official' drug trafficking channels as such, *i.e.* created by DS, but that the Bulgarian security services had maintained contacts with drug traffickers and rendered some protection for over twenty years. Dimitrova's source notes that, during all those years, revenues from drug trafficking had been going into the treasury.

2005) come as little surprise. And such funding operations inevitably involve the use of laundering techniques.

State funds embezzlement: socialist crime-money

During the socialist era some members of the ruling elite with easy access to money and privileged information were lured by the opportunity to profiteer and take advantage of the lack of proper public accountability. During those years, however, gross impropriety was not as endemic as it became towards the end of the regime when the embezzlement of state funds seems to have escalated and expanded on a massive scale (see Manolova, 2002). Those in the upper political echelons who were able to see the insecurity of the political system and foresee its collapse, reportedly ensured continuity in their control over national assets by diverting part of these assets into private companies and accounts, using laundering techniques. Such processes occurred in many of the former socialist countries, including East Germany, former Yugoslavia, Bulgaria and Russia. Frydman *et al.* notes (1996) that in countries such as Hungary, Poland and Russia, several years before the collapse of the regime, "*personal enrichment among Party ranks became a semi-official part of last-gasp 'reform' policies pursued by the regime*".[272] The last few months of the regime were marked by active asset pilfering and 'spontaneous privatisation'.[273] 'Spontaneous privatisation' was largely associated with allegations of corruption and cronyism. According to some analysts, the most notorious instances of 'spontaneous privatisation' occurred in Hungary in 1988 and 1989 (Frydman *et al.*, 1996; see also Gatsios, 1992; Kaufmann and Siegelbaum, 1997). But the phenomenon was also wide-spread in all other countries of the former socialist block, *e.g.* Czechoslovakia and then the Slovak Republic (see Mikloš, 1995), Yugoslavia and Serbia (see Sukovič, 2001), Poland (see Rondinelli and Yurkiewicz, 1996), Russia and Ukraine (see Frydman *et al.*, 1993) and further afield (see Lieberman, 1994; Frydman *et al.*, 1993).

272 The first paragraph of the section entitled "The Rise of the Kleptoklatura" (no page number is available, as the article was retrieved online).

273 'Spontaneous privatisation' is a term coined to denote forms of privatisation where the assets were still state-owned but increasingly used in private interest, often, by their managers (see Stanchev, 2004c). This occurred mainly in the last few years of the former regime or during the early years of transition to market economy, when official privatisation laws were either lacking or still in their infancy.

Bulgaria was no exception.[274] Bulgarian nomenclature knew that the collapse of the regime would mean loss of markets and revenues. So they had to be prepared for that. Capital flight in Bulgaria had begun before the opening up of the country's borders and it was reportedly the result of massive asset stripping and funds embezzlement: socialist-state crime-money flowing out of the country. And of course, these transactions largely required the use of laundering techniques.[275]

The existing network of Bulgarian trade firms registered abroad came to be used as a convenient channel to funnel money out of the country in the years preceding the collapse of the regime. The Bulgarian authorities, including DS and the foreign trade ministry, set up companies in Western Europe to penetrate the market system of the capitalist world and conduct export-import operations (see Manolova, 2002). But at some point these companies came to be used also for exporting funds, as many of those who worked in the foreign trade sector and were familiar with the network of corporate entities, were able to abuse the system. According to Manolova (2002), off-record economic transactions in the activities of these companies were a common practice. She discovered secret filings, according to which, Icomev (a company, registered abroad but operating in Bulgaria under Resolution N 148, mentioned earlier), was to receive $7 million yearly from the Bulgarian state. However, Manolova found no records of sales, revenues and taxes. It would be practically impossible to trace and recover such money from 'non-existing' transactions.

Manolova (2002) describes how funds were channelled out of the country through various schemes, including the purchase of outdated equipment and licences for 'know-how' from foreign companies. The equipment and licences cost millions of dollars but were of no use to state enterprises. Those directly involved in the schemes were, of course, aware of that but they had little to lose. They were able to personally benefit from these schemes, firstly by diverting money into personal accounts abroad, and secondly, by pocketing substantial kick-backs.

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274 As mentioned earlier, the author of this thesis is a native Bulgarian and therefore case studies in this chapter centre primarily on Bulgaria. Additionally, it is worth noting that to an extent Bulgaria was a special case because of its higher dependancy on the Warsaw Treaty. Bulgaria was largely regarded as the most loyal ally of the Soviet government in Central and Eastern Europe. The country was most dependent on the trade within the Warsaw Treaty (see Dobrinski, 1997; Dimitrov, 2004) and therefore, of all socialist countries in Europe, Bulgaria was economically probably most affected by the collapse of the socialist regime.

275 These were the early years of development of the legal concept of laundering, around the time of the adoption of the Vienna Convention and the Basle Statement of Principles.

Money was channelled out of the country also through the purchase and crediting of foreign firms and funding of some economically non-viable projects abroad (Manolova, 2002). It is difficult to attribute the losses from that time merely to poor management. But we can only speculate how much of that money went into the personal pockets of some of those who were involved in these activities.

The outflow of capital, which was apparently accompanied by large-scale corruption and embezzlement, contributed to the economic crisis that occurred when the socialist system collapsed.[276] Without a doubt, the Bulgarian nomenclature benefited from the massive, yet largely unrecorded, outflows of funds. The nomenclature had inside knowledge that the economy was no longer sustainable and that the regime was coming to an end (see Stoev, 2004; Manolova, 2002). The nomenclature needed to ensure that party funds would remain intact and in the hands of a limited number of people who had privileged information about the channels of money flows. During the 1980s, companies registered abroad, mushroomed in the process of creating vehicles for 'red capital'[277] flight. Money was reportedly being channelled not only to less developed countries in the Middle East, Africa, Asia and South America, but also to the West, into developed countries such as Western Germany (see Manolova, 2002). However, the system of reporting suspicious transactions was yet to be developed and any of these outflows could have hardly been recorded as laundering.

An aspect of the criminal management was the disappearance of written evidence. As mentioned above, records of revenues from that time are scarce and unclear, which makes the tracing of money virtually impossible.[278] Important documents, which could have shed more light on the missing funds and

276 In March 1990 the Bulgarian government declared unilaterally a moratorium on foreign debt repayment (in 1991 Bulgaria's foreign debt amounted to 150% of GDP; as of the end of 1992 the Bulgarian foreign debt amounted to $11,3 billion, $8,5 billion of which was owed to Western private banks (see Stoev, 2004)). Around the same time, other countries including Poland and Russia also defaulted (see Zank, 2001). The crisis was caused by a number of factors, notably the collapse of an economically unsustainable regime. In the case of Bulgaria, firstly, in the late 1980s, Soviet subsidies had already stopped while Bulgaria continued to credit countries in the Middle East and elsewhere. Secondly, the government borrowed funds from Western banks but little was invested in productive economic areas. But most importantly, there was also apparently an element of mismanagement or criminal management.

277 As mentioned elsewhere in this thesis, the term 'red capital' was coined in the 1990s to denote the Communist Party funds allegedly embezzled by high-ranking representatives of the former regime and channelled out of Bulgaria.

278 While the national debt was growing, profits from foreign trade were apparently disappearing.

the accumulation of debt, have disappeared from the secret archives of the Bulgarian Foreign Trade Bank[279] (see Manolova, 2002; see also Stoev, 2004).[280]

As noted earlier, in the late 1980s, just before the collapse of the regime, capital flight escalated and was also streamlined. On 9 January 1989, during a meeting of the Bulgarian council of ministers, the then Economy Minister Stoyan Ovcharov presented a confidential report, which predicted the end of the planned economy and the beginning of the transition to market economy. According to this report, a number of key firms were to be set up in each industry. Certain groups of individuals were to be responsible for taking control over the various economic areas. A limited number of people, including economists from the upper echelons of the party as well as state security service agents, were reportedly assigned with the task to 'prepare the transition to democracy.' Similar processes occurred in other former socialist countries, including East Germany, former Czechoslovakia and Poland (Manolova, 2002).

This 'transition to democracy' proved to be a coordinated grand theft. Political entrepreneurs in Bulgaria became highway robbers (Stoev, 2004). Through all stages of red capital flight, in order to conceal the traces of profit, including embezzled aid to poorer countries and revenues from illegal re-export transactions and arms trade, the nomenclature needed to create companies in Bulgaria and abroad, and place trusted agents to carry out the work and effectively 'launder' the 'red money'. Ironically, as it seems, those who had previously been actively involved in anti-capitalism propaganda were the ones who, in the early years of transition, became the *nouveaux riches*. They created the first private banks and took control over the best state assets at the expense of ordinary taxpayers (Hristova and Stanchev, 2004; Stanchev, 2004a, 2004b, 2004c).

The most convincing evidence of the massive accumulation of capital of unknown origin, largely laundered in the West, was the fact that a powerful business elite emerged in Bulgaria (and other transition countries) too quickly after the collapse of the regime. It is inconceivable how relatively young people

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279 The Bulgarian Foreign Trade Bank was established in 1964 as a state-owned bank to serve the state's international payments and finance. In 1994 the bank was renamed Bulbank and in the late 1990s it was privatised.

280 These documents included a list of 161 firms, which received funds totalling $1 billion between 1985 and 1989. During the same period the state held its reserve currency in seven accounts. While in 1985 the total amount of currency reserve amounted to $2,46 billion, by 1990 the amount had decreased to $490 million. A large portion of the funds disappeared during the last few months of this period – between 1 December 1989 and 6 April 1990. As a result of this, among other factors, Bulgaria had to stop paying its foreign debt (see also *Capital Weekly's Blog*, 12 September 2010).

such as Iliya Pavlov, the founder of the controversial conglomerate MultiGroup (now defunct), and Emil Kyulev, a high-profile banker in Bulgaria, could have become so wealthy so soon after the beginning of the transition. It appears that they had the resources to successfully launch and develop their private business ventures. Given the obscurity of these resources, it is plausible to assume that the capital used by many of the *nouveaux riches* at that time had gone through some sort of laundering process before being re-invested. But who, if anybody, asked critical questions at the time?[281] Certainly not the western banks through which the funds transited, or the authorities that let the money be invested in privatisation.

Clearly asset stripping had begun before the opening of the borders. In the case of Bulgaria, as we have seen, asset stripping was largely accompanied by capital flight. But this was just the criminal prelude: the most significant part of the national assets in the socialist block was apparently yet to be pilfered.

4.1.2. The transition years

The transition to market economy meant that national assets had to be placed in private hands. The lack of an adequate legal framework made it possible for the former nomenclature and a number of time-servers and opportunists to seize considerable shares of the national wealth. The distribution of national resources, which had started before the collapse of the regime, continued after that point but in the form of official privatisation.

Privatisation was tainted with allegations of corruption in all countries of the former socialist block (see Kaufmann and Siegelbaum, 1997; see for further specific country analysis Mikloš, 1995; Sukovič, 2001; Rondinelli and Yurkiewicz, 1996; Frydman *et al.*, 1993). However, there is relatively little proof that asset stripping under the cover of privatisation has been accompanied by massive capital flight. The reason for this is not the absence of capital flight, but the lack of reliable official statistics on capital outflows and the lack of public statistics on suspicious reports on such inflows in the West. These are either lacking (in the early years of transition[282]) or they failed to capture all 'shadowy' cross-border flows of funds.

281 When both were killed in the early years of this decade, it was rumoured that they had become defiant with those who had created them.

282 See Antzoulatos and Sampaniotis, 2001, for an account of availability of published balance of payments data in the transition countries during the 1990s.

The case of Russia

Yet it seems that Russia makes a significant high point, as no other country has attracted as much attention with regard to capital flight (and allegedly related laundering – see below) during the transition period. According to Antzoulatos and Sampaniotis (2001), capital flight became a serious problem for all Eastern European countries during the 1990s. They, however, admit that the problem has received little attention and that the few existing studies on capital flight in the transition economies have focused primarily on Russia rather than any other country. It appears that the scale of capital flight in Central and Eastern Europe or the new independent states never reached the gravity it reached in Russia.[283] According to Garibaldi *et al.* (2001), among the transition countries Russia was the only net exporter of capital in the late 1990s.

> Abalkin and Whalley (1999) suggest that capital flight from Russia amounted to \$56-70 billion in 1992-93. According to some estimates, between 1994 and 2000 the average annual amount of capital flight from Russia was \$20 billion or approximately \$150 per capita (Loungani and Mauro, 2000, Loungani and Mauro also quote data provided by the Russian authorities, according to which capital flight was around \$11 billion yearly between 1994 and 1998; see also Tikhomirov, 1997; Loukine, 1998; Abalkin and Whalley, 1999; Cooper and Hardt, 2000, for an account of further estimates). These estimates were done in accordance with the 'hot money' measure, while according to the 'broad' measure, the amount was \$15 billion or approximately \$100 per capita (Loungani and Mauro, 2000).[284]

At the same time, some studies indicate that capital flight from Croatia, Hungary, Poland, the Czech Republic, Slovakia and Slovenia was not only substantially lower, but after some time it reversed: capital in-flight. During the early years of transition capital flight from these countries averaged \$15 per capita (according to the 'hot money 1' measure), while between 1993-98 capital flight reversed with average inflows of \$75 per capita (Fisher and Sahay, 2001; see also Sheets, 1996). The situation was similar in the Baltic States (Loungani and Mauro, 2000).

283 A number of authors note that Russia has been a 'special case' (see Loungani and Mauro, 2000; Fisher and Sahay, 2000; Garibaldi *et al.*, 2001).

284 The measures are generally defined as follows: (i) hot money 1: net errors and omissions plus net flows of non-FDI, non-portfolio investment assets and liabilities held by entities other than the monetary authorities, general government, and banks; (ii) hot money 2: hot money 1 plus net flows of non-FDI, non-portfolio investment assets and liabilities held by banks; (iii) broad measure: hot money 2 plus net flows of portfolio investment assets and liabilities in the form of debt securities (see Loungani and Mauro, 2000).

Some studies also suggest that capital flight from Russia intensified in 1996–97 (Loungani and Mauro, 2000) just prior to the 1998 financial crisis. It slightly declined after the crisis and the rouble depreciation because of tightened capital controls, but soon resumed, increasing again with the oil price increase (Westin, 2000).

Generally, it is believed that capital flight is driven by the need to ensure the best possible environment for capital return when the existing environment is unsteady. Therefore flight capital is not part of the usual investment portfolio such as maybe a UK investment in the German real estate market. Economic and political instability, as well as high taxation, drive capital away. However, some capital may leave the country to escape regulatory measures. This means that flight capital may include not only funds from legitimate activities which flee the country for legitimate purposes such as fears of devaluation or an insecure banking system. Flight capital may also include two additional broad categories of money: legitimate funds which leave the country for illegitimate purposes such as tax evasion; illegitimately earned money which seeks a harbour from regulatory retaliation measures. These categories can often overlap because the evaded tax becomes criminal income. Also, criminals may seek to take their money out of the country not only to escape confiscation but also to achieve a higher return on their investment or to launder their money.

The UNODCCP,[285] for instance, quotes estimates made by Abalkin (1998) that between 1992 and 1997 the amount of capital flight from the Russian Federation that is likely to have been related to money laundering (it is again not clear from the report how it was related) is $133 billion. Abalkin and Whalley (1999) also suggest that 33%[286] of the estimated $68 billion accumulated abroad by Russian residents in 1994–97 comprised illegal capital flight, while 37% could be defined as 'semi-legal' (again, it is not quite clear what this entails). The remaining portion of these funds came from various informal financial transactions. The authors of this study clearly suggest that a substantial part of Russian flight capital comprised tainted, *i.e.* criminal money.

Does this mean that capital flight was largely related to money laundering, and, if so, in what way? Abalkin and Whalley (1999) highlight that the main reason for Russian capital flight was political and economic instability, rather than the fear of expropriation. This applied to a large part of the international

285 The United Nations Office for Drug Control and Crime Prevention

286 Other researchers suggest that around one third of capital flight comes from illegal activities (see Cooper and Hardt, 2000).

transactions[287] carried out during the early and mid-1990s. However, there was also capital that left the country, not because of general instability, but to escape scrutiny from regulators. The difference, however, between money flows that escape regulators and money flows that escape instability (as long as these relate to tainted money), is blurred: tainted money is always targeted by regulators. The internationally adopted definition of money laundering sets the term in a broad sense. Therefore, it is easy to accept that if a large portion of capital flight was tainted money (for instance from tax evasion), then the volume of flight capital relating to laundering (for instance, of the tax money) indeed reached high figures (which brings us back to the same tautology that shapes a vicious circle).

At least on three main occasions Russia came under scrutiny, specifically as a source of flight capital related to money laundering: privatisation, the financial crisis in 1998 and IMF funding.[288] Press reports have extensively covered these events.

Privatisation in Russia was accompanied by massive asset stripping and related capital flight. Stiglitz (2002, p. 144) notes:

> "*Privatization, accompanied by the opening of the capital markets, led not to wealth creation but to asset stripping. It was perfectly logical. An oligarch who has just been able to use political influence to garner assets worth billions, after paying only a pittance, would naturally want to get his money out of the country.*"

As in the other transition countries, privatisation in Russia began with instances of 'spontaneous privatisation'. As Stiglitz observes (2002, p. 158):

> "*Privatization in Russia turned over large national enterprises, typically to their old managers. Those insiders knew how uncertain and difficult was the road ahead. Even if they were predisposed to do so, they dared not wait for the creation of capital markets and the hosts of other changes that would be required for them to reap the full value of any investments and restructuring. They focused on what they could get out of the firm in the next few years, and all too often, this was maximized by stripping assets.*"

287 In addition to international transactions there was also a form of 'internal capital flight' or 'dollarisation', *i.e.* active use of foreign currency, particularly US dollars, instead of local currency by local residents (see Abalkin and Whalley, 1999; also Cooper and Hardt, 2000).

288 Press reports indicate that in late 2003 and 2004 capital flight somewhat intensified again. This was just after the Russian government had launched its first attacks against the oil company Yukos. This subsequent capital flight was largely driven by the political uncertainty and fears of state monopolisation and to a large extent comprised outflows of foreign investments.

However, in the opinion of Stiglitz and many other analysts, the most notorious instance of reprehensible privatisation in Russia was the loans-for-share programme. It was invented in the mid-1990s by a number of individuals close to the government under then president Boris Yeltsin. The effect of the programme was that the government exchanged Russia's most valuable national assets for bank loans that were apparently bound to never be repaid. The banks which granted the loans were controlled by those who invented the programme. As Stiglitz further notes (2002, p. 159):

> "*These privatizations had no political legitimacy. And [. . .] the fact that they had no political legitimacy made it even more imperative that the oligarchs take their funds quickly out of the country – before a new government that might try to reverse the privatizations or undermine their position came to power.*"

The ownership of privatised companies was usually transferred to offshore firms.[289] Thus, formerly state-owned assets were now held in other jurisdictions via complex schemes of trusts and nominee shareholdings, which made the assets virtually unreachable. Revenues usually flew offshore as well. In particular, companies in the energy sector were largely believed to have contributed to capital flight by non-repatriation of export earnings (see Loungani and Mauro, 2000; Kadochnikov, 2005). False over-billing by foreign 'clients' or false losses written off as bad debts, misrepresentation of export earnings, fake advance import payments and other transactions evading regulations are some of the usual methods that have been used in Russia for covering capital flight and related money laundering (see Cooper and Hardt, 2000; see also Loungani and Mauro, 2000; Jack, *Financial Times*, 1999).

We should not forget, however, that a large part of the privatisation deals and export-import trade agreements were carried out in line with the then existing regulations, or rather (on some occasions) the lack of regulations. Of course, the unethical and corrupt methods of privatisation raise the question of its illegitimacy. Given the defective legislation, it is difficult or even impossible now, to prove that many of those assets have been acquired illegitimately, let alone by outright criminal means.[290]

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289 Records in the Russian company registry indicate that during the 1990s an extensive number of Russian firms, including privatised companies and major Russian enterprises, had a non-transparent shareholder structure with a number of layers of offshore firms and nominee shareholders. There is now an increasing trend of bringing in transparency in company corporate structures, specifically in large firms which seek to form partnerships with foreign investors.

290 Many of those seeking to gain control over enterprises were alleged to have acquired their initial stakes through unlawful privatisation, and to have subsequently violated the rights of other shareholders in order to acquire further shares. There have been numerous media reports on this

Along with asset stripping during privatisation (much of which was unethical but not necessarily illegal), Russia also experienced asset stripping related to the liberalisation of the financial sector, particularly the banking system. In addition to financial pyramids such as the notorious investment enterprise MMM, a number of banks also operated as pyramids on the verge of bankruptcy. In the early 1990s many banks delayed financial transactions and payments to clients seeking to gain a quick profit from the short-term investment of the deferred money. Additionally, throughout the 1990s, and especially around the time of the financial crisis in 1998, a number of banks went bankrupt leaving their customers virtually with nothing. Many of these banks were used by their owners to steal the money from their clients under the convenient cover of the financial crisis. Financial assets were shifted to foreign bank accounts and offshore entities with all trails concealed. A large portion of the stripped assets was transferred via bridge banks to newly established banking institutions (see UNODCCP, 2001).[291] While a few bankers became the subject of investigation, the majority remained untouchable and unharmed by regulators and law enforcement authorities.

A similar process took place when the IMF granted a loan to the Russian state during the time of the 1998 crisis. In July 1998 the IMF agreed to grant \$11,2 billion out of a total \$22,6 billion package, of which \$6 billion was to be granted by the World Bank and the rest was to come from the Japanese government. The funds were to be provided in several instalments. In July 1998 the IMF granted \$4,8 billion[292] (see Stiglitz, 2002, for an account of the events). Throughout 1998, in the months preceding the August 1998 peak of the crisis, investors sought ways to flee Russia but this apparently did not stop the money lenders, *i.e.* the IMF *inter alia*. Subsequently, as it appears, the main reason why Russia became again the target of global critical scrutiny was not so much the

subject. In late 2004 Russia's Audit Chamber produced a report on the results of analysis of privatisation in 1993-2003. The report provided a long list of enterprises the privatisation of which was marred by violations of laws and regulations (see Yurova, *RIA Novosti*, 2004). However, there have been relatively few cases where the authorities have sought to reverse privatisation of specific enterprises. In 2006, in relation to discussions on parial privatisation revision, the media quoted Alexander Shokhin, a representative of the Russian Union of Industrialists and Entrepreneurs, as saying: "*If there were any violations in the privatization process and the statute of limitations has not expired, the results can be reviewed […] [b]ut if moral and ethnical standards are concerned, then it would be senseless to review the deals*" (reported by *RIA Novosti*, 2006, 4th paragraph).

291 The topic has been extensively covered by the press.

292 Other reports suggest that money from earlier IMF parcels, in particular from 1996, has been channelled by Russia's Central Bank to a firm it allegedly controlled, Financial Management Co. (or Fimaco), registered in the Channel Island of Jersey. The IMF announced that it was looking into these reports (see World Bank's newsletter Beyond Transition, 1999; also Cooper and Hardt, 2000) but it is not quite clear what exactly has been unearthed since then.

flight of investment, but the alleged flight of the very funds granted by the IMF to stem the crisis. As soon as the first instalment was made, the money was allegedly largely taken out of the country. Circumstantial evidence of this widely reported assertion consists of the fact that approximately three weeks after the loan was granted, Russia announced a moratorium on debt payments, which could mean that the granted money hardly reached its designated goal. As Stiglitz (2002, p. 150) observed:

> "*We felt that it would take days or even weeks for the oligarchs to bleed the money out of the country; it took merely hours and days. [. . .] the billions of dollars that [the IMF] had given (loaned) to Russia was showing up in Cypriot and Swiss bank accounts just days after the loan was made [. . .].*"

In the following years after the crisis the Russian and international media reported[293] on continuous attempts by regulatory authorities to track down the missing funds. In particular, in May 2002 the media reported that representatives of the Russian Audit Chamber requested assistance from the Swiss authorities to trace funds which amounted to nearly $5 billion.

High-ranking auditors were quoted by the media as saying that the money 'dissolved' as soon as it was allocated to several banks, including SBS-Agro (also mentioned in UNODCCP report, 2001).

To make the story even more complicated we should add the Bank of New York connection. Bonner and O'Brien reported in *The New York Times* on 19 August 1999 that millions of dollars had passed through the Bank of New York in a large-scale 'money laundering' operation carried out by Russian organised crime groups. Additionally, it was claimed in the press that the Bank of New York had handled IMF stolen funds. The affair became widely known as the BONY money-laundering scandal.[294]

While Russian capital flight seems to have attracted most of the attention of international regulatory organisations, press and academic researchers, developments in some other countries, specifically Ukraine and Bulgaria, closely mirrored the events in Russia. Corrupt privatisation practices, cronyism and

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293 See, for example, reports in the media, including Rozhnov, *Novaya Gazeta*, 27 May 2002, and Kupchinsky, *Radio Free Europe*, 27 June 2002.

294 The Ukraine-born alleged leader of the Russian underworld, Semyon Mogilevich, was reportedly one of the key figures in the BONY money laundering operation (see Friedman, 2000; Bonner and O'Brien, *The New York Times*, 1999). According to internet references and press reports, Mogilevich settled down in Hungary in the early 1990s (having first immigrated to Israel during the 1980s), where he established a number of companies and is likely to have invested vast amounts of tainted money. As mentioned above, capital flight from Hungary was on a relatively small scale in the early 1990s, and even reversed in the second half of the 1990s – investment inflows may well have included Mogilevich's money.

rent-seeking,[295] asset stripping and capital flight have been equally common phenomena there too, and consequently, the lack of adequate scrutiny of money's origin, *i.e.* a wealth of laundering opportunities (see Van Duyne and Donati, 2008, for an account on Serbia).

Bulgaria

Similar problems have occurred in Bulgaria. Bulgarian 'credit millionaires', for instance, as they became known, were largely the product of transition that lacked the necessary check-and-balances system and an adequate legal framework. The phenomenon of 'credit millionaires' emerged during the 1990s and referred to companies and individuals who managed to obtain unsecured credits that were extended by private and state-owned banks and were never (fully) repaid. These unwise or corrupt lending practices were one of the main reasons for the financial crisis in Bulgaria in 1996, when many banks collapsed. According to the Bulgarian Secret Service Files Commission,[296] the total amount of bad debts, including unsolicited ones, was estimated to be BGN 608 million ($273 million), of which BGN 83 million ($37 million) was unsecured.[297] Evgeni Dimitrov, then deputy chairman of the Commission, confirmed to the media that the majority of the companies which had taken credits made no investments at all. Some of the loan-takers exported the money out of the country. Dimitrov suggested that this would not have been possible without a 'political umbrella', that is to say protection from, and collaboration with, certain political leaders.

During the 1990s, a number of crony banks which had absorbed money from the state budget, international financial aid and money from private depositors went bankrupt with the money almost literally evaporating. As Peev (2002) notes, the key factors forcing new domestic capitalists to take their money abroad included fear of confiscation. Although estimates about capital flight are largely tentative, media reports[298] suggest that according to Bulgarian prosecutors, capital flight amounted to $20 billion during the late 1980s and

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295 Rent-seeking is the practice of seeking to profit by manipulating the economic environment, rather than by producing any actual added value.

296 The commission, also known as Commission Andreev, was created in 2001 and dissolved in 2002 amidst political battles and debates as to whether there should be access to the archives of the former Secret Service.

297 Reports emerged in various Bulgarian media, including on national TV channels and the *Bulgarian National Radio*. See also Vatahov, *SofiaEcho*, 11 April 2002; some other sources quote different estimates.

298 See article by Lazarova, *Epohalni Vremena*, 21 July 2006 (Lazarova quotes radio *Darik News* as original sources).

early 1990s. Large quantities of money were reportedly transferred abroad via Bulgarian foreign trade companies (despite emerging anti-money laundering legislation, some of this money was allowed to be placed in Western banks).[299] It has also been suggested in the press that only in 1990 the amount of state funds transferred from the currency reserve into private hands abroad was estimated at $2 billion (see interview with former prime-minister of Bulgaria, Dimitur Popov, in *Dnes*, 21 January 2010).

Other studies suggest that approximately $13 billion of state assets was transferred to cronies of the nomenclature between 1985 and 1995 (Pejkov, 1996) and it is likely that this sum was largely taken out of the country.

Clearly, in its largest part, these estimates refer to capital flight that had started before the opening of the borders (as discussed in the previous section) but continued after that point. However, it continued not because there were no longer cross-border barriers but because the start of transition made national assets easily available under the pretext of privatisation and market liberalisation. Indeed, the fall of cross-border barriers and globalisation offered laundering opportunities. The people who took advantage of that (many of them were reportedly cronies of political leaders with access to 'red capital', as discussed previously) had to insure themselves against consequent expropriation.

An article by Antonova published in *Sega* on 29 July 2003 quotes Professor Vladimir Kvint as saying that between 1990 and 2003 around $7 billion fled Bulgaria.[300] The same article also quotes the then finance minister Milen Velchev commenting on Kvint's assertion. According to Velchev, the main part of the flight capital has returned to Bulgaria and has flown into the privatisation process. Velchev noted that the Bulgarian legislation had not created any barriers to the repatriation of flight capital, for instance, via offshore firms. Indeed, if we look at corporate filings listing the shareholders of newly acquired assets in Bulgaria during the 1990s, we will see that many of these assets were bought by offshore firms. The lack of adequate legislation and check-of-balances systems implies, of course, the possibility that not only domestic tainted money can return as investment, but also foreign tainted money can easily flow into transi-

299 It has been suggested in the media that money was also taken out of the country literally in suitcases. According to some representatives of the former regime, reports about money taken out of the country, including in suitcases, remain speculation (see interview with Georgy Atanasov, former prime minister, Kovachev, *24 Chasa*, 1 November 2009).

300 According to him, $3billion fled Albania and over $170billion fled Russia.

tion countries. This means that there may have also been a reverse effect: dirty western capital seeking a 'laundering refuge' in the East.[301]

Ukraine and other former socialist countries

Similar to Russia and Bulgaria, inadequate economic policies during the early transition years in Ukraine resulted in the expansion of the underground economy and substantial capital flight which, according to some estimates, reached nearly $2 billion in 1993 (see McCarthy *et al.*, 1994). Similar to Russia, in Ukraine too, during the early years of transition, the need to contain the political-criminal nexus received little attention (Shelley, 1999).

Almost all other transition countries have experienced comparable problems (massive bank fraud and a major financial crisis, although, as noted above, less so in terms of capital flight), at some stage. Lithuania was among the first, experiencing a crisis in 1995, when some of the country's major banks were closed and senior bank executives were arrested on suspicion of fraud. Russia was hit in 1998 (as mentioned above), while in Croatia the crisis occurred in 1999. According to Baloun and Scheinost (2003) the practice of siphoning off assets and funds from banks, savings and credit cooperatives and other organisations was widespread in the Czech Republic too (they describe the phenomenon as 'tunnelling').

Although it is likely there were inflows of tainted money into the transition countries, there is little evidence to suggest that large drug trafficking cartels and other organised crime groups from all over the world rushed to invest or deposit their ill-gotten earnings with banks in these countries.[302] Rather, it was tainted proceeds generated in the transition countries that flew into the West-

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301 The same applies to investment inflows into Russia (even though they were of relatively small scale during the 1990s). The Center for Strategic and International Studies (1999), a Washington-based think tank, suggests that between 1992 and 1999 the total net foreign direct investment in Russia amounted to $11,6 billion. Although difficult to prove, it is possible that part of it was reversed capital.

302 There have been media reports suggesting that tainted or hot money had been invested in transition countries, including Bulgaria. For instance, (as previously mentioned) it has been reported that IRA has been laundering crime proceeds through the acquisition of property in Eastern Europe, particularly Bulgaria, where IRA was believed to have invested in property developments valued at around €15 million and to have intended to buy a bank to facilitate its financial operations (see Murray and Cusack, 2006). Based on informal discussions with contacts in the banking sector in the West, it appears that Bulgaria has been viewed by many, for a number of years, as a possible laundering destination for dirty capital. However, there is little evidence that investment of organised crime proceeds was done on a massive scale in Bulgaria or other transition countries, on a scale larger than anywhere in the West (this subject will be discussed later).

ern financial system for the perfect whitewash effect[303] and as a measure against expropriation. Organised crime bosses, along with many of those who enriched themselves during privatisation and the liberalisation of the financial system (also those who participated in the asset distribution prior to the collapse of the regime) could have easily taken their money out and then brought it back into the country as foreign investment, *i.e.* laundered. The opening of the borders was not the reason for the massive outflows, as the outflow had begun prior to that point. However, the process of integration of the former socialist countries into the global capitalist world certainly facilitated the circulation of dirty money. The years of transition to market economy was a time of opportunity to steal under the pretext of privatisation. It was a time of crime money generation. Partly through this global circulation of dirty money, illegally and unethically derived wealth eventually became gentrified.

4.1.3. The gentrification of crime money

Some compliance officers at international financial institutions still view Bulgaria as having a 'bad rep'[304] (bad reputation). Many also fear dealing with large businesses in Ukraine and some other emerging markets. However, business in Bulgaria, Russia, Ukraine and other former socialist countries has undergone a process of evolution (as mentioned elsewhere in this thesis). Transition in these countries started with massive asset stripping and organised crime. Hostile takeovers and corporate raids involved physical threats and intimidation (see Firestone, 2010, for an account of this phenomenon in Russia).

Gradually, however, many of those high-flying businessmen who had accumulated their wealth during the transition years (albeit in a highly controversial manner) realised that if they wanted to expand and look for financial resources on international stock markets, they would need to restructure their businesses, streamline them into transparent and 'clean' corporate structures that every international investor would be happy to deal with. Indeed, despite their somewhat 'bad rep', Bulgaria, Russia and Ukraine have managed to attract the interest of investors. The risk became to be viewed by many as 'manageable'. This means, perhaps, that the evolution of business has been accompanied by an international process of reconciliation with (or perhaps to an extent even

303 The Bank of New York scandal is a good example of such a process. Tainted money was allegedly channelled from Russian and Latvian banks, *inter alia*, through offshore banks into the Bank of New York (see Block and Weaver, 2004).

304 A professional slang used by some compliance officers.

facilitation of) what appears to have been 'transition washing.' But this process of gentrification has been observed not just in the emerging and developing countries. In the end, the requirements of economy and taxation grind all colours of money into white (or "*diffusion by integration*" as once happened in the US, see Van Duyne, 2003b, p. 76).

4.2. The hidden economy and money laundering

Money laundering is usually associated with predatory crime and contraband trade. However, conceptually it is also associated with the hidden economy, especially considering that (as time went by) tax evasion in most jurisdictions became also a predicate offence – in terms of monetary volume, a major predicate crime indeed. This implies, given the broad definition of money laundering, that in countries with considerable hidden economy the volume of money laundering is also high: almost a tautology. Nevertheless, this link seems to be almost as elusive as comparing apples and oranges because of their essentially different nature (speaking in strict terms), the fuzziness of the two concepts (of laundering and of hidden economy, although tax evasion, which is related to both phenomena, is quite an unambiguous term) and the difficulty to identify one single method to measure them. This section will examine the multi-dimensional concept of the hidden economy, the range of different approaches in measuring its size and the feasibility of linking the results of such measurements to money laundering.

4.2.1. Definition of hidden economy

Clearly, the argument of policy makers that money laundering is a threat to society sounds more convincing if figures show substantial money laundering volumes. Quirk (1997) notes that in order to demonstrate the significance of the money-laundering phenomenon for the macro-economy, it is necessary to prove that it takes place on a large scale relative to the overall economic activity. One way of demonstrating this is to link money laundering to the hidden economy, especially in countries where the hidden economy is regarded as considerable, almost by definition. Walker (1995), for example, suggests that as criminals make no official records of their income, the understatement of income could be regarded as an indicator of money laundering (see also National Criminal Intelligence Service, 2003, and Walker, 2004). As easy as it may seem, however, as Quirk (1997) notes, early attempts by economists and law enforcement bodies to measure the hidden economy as a substitute for money laundering has resulted in a wide range of estimates. It remains an issue as to how reliable such estimates can be, given the uncertainty surrounding both phenomena.

The phenomenon of the hidden economy is often described as 'shadow', 'underground', 'virtual', 'grey' or 'black'. Hidden economy exists not only in the countries of transition but also in developing as well as underdeveloped economies. But more importantly, it also exists in advanced economies. The transition and developing countries share this economic phenomenon with virtually all 'old' capitalist states (Henry and Sills, 2006); hence, it is inherent in any country with a 'price wedge',[305] either on labour, products or income. However, it is more evident in markets of transition as the emergence of a parallel, hidden market which functions in conjunction with the legitimate mainstream economy is believed to be part of the transition process. As we have seen in the previous section, hidden economy had existed prior to the opening of the borders but it quickly expanded after that point. To an extent, the hidden economy can be described as the reverse side of defective government.[306]

Evidence of the size of hidden economy is evasive. There is also no clear consensus with regard to the terminology and definition of the hidden economy. Terms are often used interchangeably. There are various approaches or combinations to approximate the volume of the black economy.

A World Bank research paper by Kaufmann and Kaliberda (1996) distinguishes two main types of hidden economy. First, it is the *unofficial* economic activity of 'non-criminal nature', which involves the provision of legitimate products or services, but the added value remains unrecorded because of deliberate misreporting or evasion. In this respect, Kaufmann and Kaliberda (1996) particularly point out the informal post-socialist economies in the former Soviet Union (FSU) and Central and Eastern Europe (CEE).[307] The second type of

[305] This is understood as the difference between international prices or prices of imported goods and the price of comparable goods/services produced domestically (see Jones and Walkenhorst, 2003).

[306] Which confirms the point that it can also exist in advanced markets.

[307] Indeed, in the early years of transition, many emerging small and medium-sized businesses with little or no entrepreneurial experience sought to fill in niches that had been previously occupied by state-owned enterprises. In order to survive they had to mitigate the burden of high tax and other costs of administrative requirements. As the legal framework at the time was not yet developed and provided rather inadequate regulatory mechanisms, businesses had the opportunity to 'visibly' operate while enjoying partly 'invisible' financial results. This means that they created

hidden economy, according to the same study, is of a *criminal* and even *violent* nature. It is historically strong in Latin America and Asia, where drug 'cartels' have operated for decades gradually spreading their clandestine activities further afield.

Kaufmann and Kaliberda (1996, p. 3), for instance, note that unofficial economy in an economic regulatory sense "*is mostly non-violent and non-criminal (in contrast to drug cartels, for instance). [. . .] But the noncriminal un-official economy appears to be much larger in most of the FSU and CEE states. [. . .] In contrast with informal sectors in Latin America and Asia, for instance, a sharp dichotomy between official and unofficial activities is often absent in the FSU and CEE states.*" However, those who have lived in the CEE and FSU countries have observed that they have also suffered from the emergence of a 'violent' economy. Illegal prostitution, child pornography, human trafficking and other activities such as extortion, which involve the provision of illegal products and services or legal services but through violence (racketeering), have been on the rise during the 1990s, since the collapse of the previous regime (see O'Neill, 1997; Volkov, 2002; Anastasijevic, 2006; Gounev, 2006).

Many would agree with such categorisation of the hidden economy, with the caveat that the first type of hidden economy can also have violent features, such as the untaxed cigarettes market in Germany where Vietnamese vendors could fall victim to extortion by country fellowmen (see Von Lampe, 2002).[308] What clearly links these two types of hidden economy is that for various reasons the financial results remain unrecorded or are only partly recorded, which means that less or no tax is being paid (with the reservation that, in the case of criminal activities, tax may be paid on the successfully laundered income; see comments below). Despite the different views and definitions, it is widely assumed that income which remains unrecorded – or else defined as 'evading tax', 'escaping official detection' and 'falling outside the purview of government accounting' – is the main component of a hidden economy (see Bhattacharyya,

a visible value and sold it for profit but this profit was misrepresented in order to pay less tax. As Kaufmann and Kaliberda (1996, p. 4) point out, these unofficial activities were conducted in "*close proximity to official activities (often within a continuum in the same line of business), [. . .] hover[ing] flexibly between officialdom and unofficialdom, largely motivated by government-induced incentives*."

308 See also Hornsby and Hobbs (2007) for an account of the violence creeping into the UK smuggling scene, not due to the smugglers themselves but to violent criminals taking advantage of a relatively non-violent market.

1999; Thomas, 1992; Feige, 1990; Schneider and Enste, 2000; Fleming *et al.*, 2000).[309]

Fleming *et al.* (2000) notes that there are four broadly comparable components of the shadow economy which comprise: the *household* and *informal* sectors, as well as the *criminal* and *irregular* sectors.[310] The household sector is household production, while the informal sector is defined as economic activities that circumvent the costs but are also excluded from the benefits of law (Fleming *et al.* quotes Feige, 1990). By definition, neither the household nor the informal sectors operate necessarily in violation of any institutional rules and laws (except for maybe, in certain cases, taxation[311]), contrary to the criminal and irregular sectors but it is often difficult to draw a line.[312] It is especially difficult to distinguish between the official and hidden economy concerning licit goods and services sold unrecorded, and between the various types of hidden economy when unrecorded work leads to savings used for transactions with registered goods and services. The economic spheres overlap in a broad transit zone. The shadow economy is like a big self-contained "*aquarium*" (see Van Duyne, 1994b, pp. 54-55), part of which we do not see, but effects are felt elsewhere (and taxed all the same). The lack of conceptual clarity and, particularly, the broad definition of laundering, do not make things any easier. All this

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309 With the caveat that it is the primary income which is not recorded, but the tax and benefits derived from spending this income may be recorded: VAT, sales tax and so on (except for consumer goods smuggled into the country).

310 Fleming *et al.* (2000) notes that in addition to the definitional approach which describes the shadow economy as 'unrecorded economic activity', there is also behavioural approach, which seeks to explain the causes and underpinnings of the shadow economy. He argues that the participation in the shadow economy can be viewed as a change in behaviour of market players that occurs as a reaction to institutional constraints. Both the definitional and behavioural approaches identify these four broadly comparable components of the shadow economy.

311 According to the International Labour Organization (ILO, 1993), the hidden or underground economy should be distinguished from the informal sector as the latter is not necessarily deliberately evading tax. The ILO defines the informal sector as a group of production units, which form part of the household sector as household enterprises. Many believe that household production should be included in the official national accounts (see Sloman, 2000; Thomas, 2003). The ILO (1993) for instance seeks to take account of the workforce involved in this sector.

312 The matter is further complicated by interpretations as to whether household and informal sectors contribute to GDP. Thomas (2003) notes that the informal sector includes workers who work from home but sell their output in the market, whereas households' output is consumed within the household, *i.e.* it is not a subject to a market transaction. Yet in countries with typically large families the household economy may be important to the official system. Vaury (2003) observes that household production creates a value 'forgotten' by GDP. So can be voluntary work and work in the public sector but these can hardly be categorised as hidden economy. This means that whether a certain value is included in the official GDP cannot be reliably used to distinguish the hidden from the official economy.

makes analysis and measurement highly tentative, particularly when we have to look at tax evasion from the perspective of money laundering.

The categorisation of the shadow economy into four sectors as outlined above – criminal, irregular, household and informal – is not suitable for the purposes of our present analysis as it is conceptually complicated, implies overlaps[313] and may include elements that do not violate any laws and regulations.[314]

Furthermore, on some occasions, household production can also be part of the criminal sector because it involves the production of illegitimate goods. In Poland, for instance, in the 1970s and 1980s, an illegal drug called 'Polish heroin', also known locally as kompot (mentioned previously in this thesis) was literally produced in people's kitchens. If it was ever provided to other addicts, it was done as a favour rather than for profit (Krajewski, 2000). This household production was part of the criminal sector and, therefore, some might argue that it would be wrong to describe it as part of the national economy and GDP. However, it can also be argued that the criminal sector involves market transactions (see Taylor, 2002), which generate an added value and income largely spent on legitimate goods or kept as savings in banks, and it is therefore part of the national economy and GDP. Is drug smuggling hidden economy? Drug smuggling is certainly a clandestine activity. However, it is clandestine not necessarily because smugglers seek to evade taxes, but because of the illegal nature of the commodity. Drug smugglers do not pay tax on their original criminal proceeds or on the added value from the criminal transactions but they may well pay tax on their laundered income. Is the sale of stolen goods part of the hidden economy and is the 'black' market part of the hidden economy? It can be argued, for instance, that the sale of stolen goods on the black market does not add any value to the unofficial GDP[315] (or we can even say that it has a negative added value as the fence's price is lower than the added value), while the production of piracy CDs and counterfeit goods creates a new value, though in an illegal way (that must be offset against the loss in the legal produc-

313 The concepts of 'informal' and 'irregular' sectors seem to overlap in certain respects. Both comprise activities that by nature are legitimate but in both sectors tax and other state requirements are circumvented. However, in the case of the irregular sector the circumvention is deliberate and unlawful. In addition, the informal sector overlaps with the household sector or is a part of it.

314 As previously noted, the household sector is not necessarily breaking taxation laws. There may be do-it-yourself work and neighbour help that avoids rather than evades tax (see Mirus and Smith, 1997; Schneider and Enste, 2000) but that can be a matter of interpretation. The authorities might argue that it is always on the egde of law breaking, at least concerning the hidden income, which requires measures of concealment.

315 It can also be argued that it does add value between the seller and the buyer. However, the predicate crime implies only a shift of wealth (from owner to thief).

tion of the merchandise). As Thomas (2003) notes, it is also important to consider that certain products may be regarded as illegal in some jurisdictions, while in others they are legitimately offered on the market. Such goods and services may be, for instance, soft drugs and services in the sex industry or alcohol in Muslim-culture dominated countries. On the other hand, household production of legitimate goods and services may fall into the category of the irregular sector.[316]

As it appears, the concept of the hidden economy is multi-dimensional. To avoid confusion, however, and for the purposes of this section, we will distinguish 'criminal economy' from 'hidden economy.' The *criminal* business, which involves the creation and distribution of *illegitimate* goods and services such as drug smuggling and child pornography, and may in fact duly pay tax on laundered criminal incomes, will be referred to as 'criminal' or 'underworld' sector or economy.

The 'hidden' economy, as opposed to the 'criminal' economy, will be regarded as:

> economic activities, which involve the production of *legitimate* goods and services and are aimed at earning a material gain through market transactions (including barter deals) but the activities, and respectively, the gain remain unrecorded and unreported or are misrepresented to evade the administrative burden and costs of various institutional requirements such as tax, licensing fees, import and export duties and other costs related to legal operation.

The 'hidden' economy involves genuine transactions, albeit unrecorded or misrepresented. For the purposes of this section, fraudulent activities aimed at making a financial gain through defrauding the state will be considered part of the 'criminal' economy. This will include, for instance, VAT fraud (even if there are legitimate goods involved but they are only a cover rather than a primary objective of the transactions) or benefit fraud. However, as we will see in the next section, it is often difficult to divide between the criminal and hid-

316 For instance, in Bulgaria, homemade rakiya (a national brandy) is not merely a commodity for sale but a cultural tradition similarly to preparing pickled vegetables. Nevertheless, on 1 January 2007 (when the country became an EU member), home-brewing of rakiya became subject to excise duty. At the time, for the average Bulgarian with a monthly wage of €200, and especially in the countryside where pensioners might receive as little as €40, to pay BGN 2,2 (about €1,1) tax per litre of rakiya (BGN 4.4 per litre if the amount exceeds 30 litres) bordered on extortion (wages have grown since but, at least as of 2010, remain among the lowest in Europe). This meant that many had to start brewing rakiya at home without paying the excise duty, thereby forming part of the irregular sector. However, to apply the money laundering concept, in the strict sense, in this case would be simply inapt.

den economies especially when it comes to defrauding the state through the existing system of tax and other duties.

The concepts of 'hidden', 'informal' and so on, are adjectives from a certain economic or political measurement perspective. After all, unless money is taken out of the jurisdiction and not returned, the fiscal mill turns every colour into white as has been argued in previous sections. But the way things stand now, a feeling of uneasiness creeps in: the line between economic and political dimensions is becoming blurred. Laundering by hiding the money under your mattress creates no value but the broad laundering definition does not allow for distinguishing that from what constitutes an economic phenomenon. On the other hand, laundering in the strict sense of the term is a transaction: it adds value as it helps money slip from the shadow into the official economy. Money laundering is only an economic phenomenon if it consists of a *transaction*. Economy is production and distribution (plus subsequent consumption), hence it is about transactions and added value.[317] A crime-money transaction is economic conduct involving crime-money and creating an added value (usually, with at least one other party, although laundering can be done by just one person alone). If there is no transaction and no added value, there is no *active* (as opposed to *passive*) economic conduct and, hence, we would not expect any visible and immediate effect on the economy. But there is still a penal-law construction and that is laundering in the broad sense. It is a legal construction after the fact which essentially relates to hiding of 'unrecorded/criminal income/wealth,' *i.e.* handling one's crime money (neutral indication), which is 'crime-money management'. The broad construction of laundering, determined by its definition, is artificial and so is its scope in economic terms. Depending on the definition, the scope shrinks or expands. Therefore it would seem impractical to seek an operational connection between money laundering in its broad sense and the domain of observables (to the extent those can be observed), such as the hidden economy, economy in general, and crime-money transactions. That means that the two domains can be connected if one applies a proper operational definition of money laundering.

The next section will look into this matter from an empirical perspective. It will examine whether such operational links can be identified between the hidden economy as unrecorded economic activities and the criminal sector, in particular financial crime and money laundering in a narrow and broad sense.

317 Except for self-sufficient economic units.

4.2.2. The link between hidden economy and laundering

The impact of the various unofficial activities largely depends on the context and the environment in which they occur. While the criminal economy (meaning the 'usual suspects' crimes such as drug trafficking) is commonly branded as evil, we tend to be more sympathetic to activities that merely circumvent tax or administrative burdens. However, in many jurisdictions tax evasion and employer fraud, as well as hiring illegal immigrants, are criminal offences too. Hence any subsequent use of the ill-gotten benefits constitutes money laundering, including in the strict sense of the term if, for instance, the employer fraudulently covers up his illegal tax savings and the unrecorded employment. In the West, tax evasion is increasingly brought within the orbit of money laundering and prosecuted as such.

Claiming social benefits, for instance, while being unofficially employed counts as fraud and, as such, it is a predicate offence to money laundering. A report by Lord Grabiner (2000) quotes data from the UK Benefits Agency, which suggests that in the UK, at any one time, 120.000 people were working and fraudulently claiming benefits leading to benefits overpayments of over £450 million a year (as of the time of the report[318]). Lord Grabiner provides a number of real examples, one of which is an unemployed family man who claimed Jobseeker's Allowance while doing several decorating jobs for neighbours in return for 'cash-in-hand' to earn some money for Christmas. Another example is a London-based organisation of bogus companies, which specialised in large-scale benefit, mortgage and property fraud, import of illegal immigrants, and illegal cocaine dealing. The organisation filed over 500 fraudulent benefit claims, worth around £4 million. Additionally, there was evidence that it was involved in 50 cases of identity fraud. Clearly, there was money laundering going on and on a fairly large scale.

In the UK, as in other EU member states, social benefit fraud, single or organised, is a major problem and it clearly needs to be tackled. However, as Lord Grabiner's report indicates, the intent and scale differ on a case-by-case basis. While the family man who was trying to earn some extra money before Christmas is only technically a money launderer, the organisation which committed fraud repeatedly and on a massive scale, should be considered a fully-fledged fraud-and-money laundering enterprise. By fraudulently earning the

[318] As of 2010, this has remained a significant problem in the UK and increasingly across Europe. According to a 2010 report by the National Fraud Authority in the UK, in 2008-09, the UK Department for Work and Pensions reported benefit fraud losses of £1.1 billion.

benefits, the organisation was concurrently providing a legitimate appearance to the money. The same applied to the illegal labour organisations in other member states, like the *koppelbaas* in the Netherlands (Van Duyne and Houtzager, 2005).

Within the realm of the hidden economy we have two different dimensions: an economic and a penal law dimension (as discussed previously). For obvious fiscal and penal law reasons, both are hidden. Some aspects of employer fraud, *e.g.* hiring workers without recording their salary, health insurance and so on, fall into the category of the hidden economy. However, by definition the employer defrauds and, thus, slips into the criminal economy, which comprises also all kinds of other fraud, including financial fraud and ponzi schemes.

In certain types of fraud (for instance, some forms of investment fraud and ponzi schemes) there is no value added, no exchange of goods and services. This is an illegal and predatory shift of assets from the victim to the fraudster, while the hidden economy typically involves actual and consensual exchange, albeit unreported, of licit goods and services. For example, with black-market trading that involves tax evasion such as VAT, excise and social insurance evasion, a value is being added but unrecorded. However, it would seem inapt to classify large-scale fraudulent social benefit claims as part of the hidden economy. Intentionally unreported or misreported economic activity usually relates to fraud (or tax evasion) and, therefore, normally by definition is part of the *criminal* economy,[319] but by its nature it is part of the *hidden* economy, which is illegal but not necessarily criminal. That is only the case if concealment leads to criminalised law breaking. A good example is illegal cartel building, which is an administrative transgression in many jurisdictions. But to hide a cartel it may be required to commit accountancy fraud, which is a serious criminal offence. Despite the obvious overlaps in criminal law terms, financial fraud and hidden economy remain two different phenomena in economic terms. But they are often mixed up which impedes analysis.

Laundering needs can also be different as in the *criminal* economy the subject of laundering is criminal profits, while in the *hidden* economy the subject of laundering is illegal savings – and we should exclude here social benefit, subsidy fraud, fraudulent VAT reclaims and non-contributions where we have illegal earnings rather than illegal savings (interestingly, in the case of environmental

319 The situation across countries may vary to an extent. For instance, as mentioned elsewhere, some tax related offences are administrative rather than criminal offences in Switzerland.

fraud we have an illegal saving, *i.e.* the saving of high processing costs).[320] Laundering the savings overlaps with the act of covering up the evasion of tax and other due payments. But this act of covering up does not always occur. The broad definition, however, even where there is no covering up, equates the management of illegal savings, including their spending, to laundering. The broad definition inevitably urges such an equation.[321] So here we hit again on the over-stretched application of the legal laundering clause (for relevant comments, in the context of Serbia, see Van Duyne and Donati, 2008). It simply does no justice to the underlying variety of situations and types of financial conduct for the consideration of which more realistic dimensions of the money laundering definition must be used.

The hidden and criminal economies can be described as two different subsets of the total unrecorded economy (see Van Duyne and Donati, 2008) and although they overlap, it would be helpful to distinguish them from each other, and even further disaggregate them into subsets, for the purposes of researching laundering and other criminal behaviours. Even if we cannot completely separate the criminal from the hidden economy, we can allocate them to two separate dimensions. 'Hidden economy' belongs to the realm of the economy. 'Criminal economy' is a penal law phenomenon *within* the economy. Laundering is a construction in the penal law world, although its material effects are to be observed in the economy. In its strict sense, laundering occurs in the criminal economy. Within the remit of the hidden economy, it would be more appropriate to speak of concealment and money management rather than of laundering, even though in the legal world concealing is laundering.

4.2.3. Measuring the hidden economy – measuring money laundering (or observables v. non-observables)?

The existence of the hidden economy is an undeniable fact, whether in Western Europe, the Eastern European transition countries, or elsewhere. In the countries of transition, one can say that practically everyone who has lived there has personally witnessed, or has most likely been a party to, unrecorded

320 Fraud is a bridge between the criminal and legitimate economy. By nature it is part of the criminal economy but it occurs within the boundaries of the legitimate economy. This particularly applies to environmental fraud, which can be more complicated than just illegal waste dumping.

321 It urges an equation of the use and management of criminal savings, gross criminal revenues and net criminal profit with laundering, even though part of the money may be used to cover business costs or daily needs without any fraudulent cover-up.

business transactions. Especially during the early transition years not only many transactions for daily living were settled without receipts, also many business transactions went unrecorded. Private enterprises mushroomed but the majority were bound to be wound up sooner or later. Entrepreneurs had little business experience and insufficient funds, and could therefore only undertake small-scale operations. A few were capable of making long-term investments but these were mainly people who were close to the former regime (and, reportedly, had access to communist party funds or 'red capital' as discussed earlier – see section 4.1.). The legal framework and regulatory mechanisms were inadequate to ensure a level playing field while corruption was widespread. The economy was still institutionally and structurally weak. Short-sighted business investment and limited financial capabilities meant that many businesses operated inefficiently or even at a loss. Banks often provided loans to loss-making industries and therefore themselves became largely loss making institutions. The banking system was vulnerable to economic depression and open to abuse as well (as reviewed in previous sections).

Financial volatility of the market, general macroeconomic instability, including inflation risk, the considerable administrative burden and all costs related to legal operations, especially the tax burden, stimulated small and medium-sized market players to conceal their income. Many even went fully 'underground' and avoided registration as an enterprise (some of this was maybe a heritage from the socialist era's black markets: 'stay away from the state'). Despite the lack of anti-money laundering laws during the early transition years, conceptually money laundering must have existed, given the broad definition of the phenomenon, if tax evasion was so endemic. Although inconclusive in detail, findings from various surveys demonstrate the existence of considerable hidden economy (specifically tax evasion) and provide statistical indicators of its dynamics over time, which helps to form a view of its scale (see below). However, can any of the approaches and indicators that are applied to assess the extent of the hidden economy, and tax evasion in particular, be effectively used to also measure money laundering, if the two phenomena overlap so strongly? And if one does so (see Unger *et al.,* 2006), what descriptive or explanatory value would this exercise have, given the broad laundering definition?

There are a number of approaches to assess the informal and black economy. Kaufmann and Kaliberda (1996), for instance, used the results of empirical micro-surveys conducted in the early to mid-1990s in Ukraine. They interviewed representatives of small and medium-sized enterprises from different samples. The majority of entrepreneurs admitted that they engaged in unofficial operations.[322] Household surveys revealed that, while officially employed workers in Ukraine were finding it difficult to cope with the cost of living, there were individuals who were not officially employed and received no social aid but were able to provide for their family, afford a car, pay their rent and so on. Were all these people money launderers? Yes, under the broad umbrella they were and, consequently, this research could be considered a money laundering measurement? But how meaningful would that qualification and the outcomes be?

A recent study of the Serbian economy also reveals that households' expenditures significantly surpass the total household income (see Van Duyne and Donati, 2008). In such cases, unless people live on credit or long term savings, they are most likely spending unrecorded, *i.e.* untaxed, income. Does that make them money launderers? Yes they too are, demonstrating again the meaninglessness of broad constructions.

Kaufmann and Kaliberda (1996) examined the link between official GDP growth and electricity power consumption[323] in order to estimate the changes in the unofficial economy between 1989 and 1994. They proceeded from the assumption that electricity consumption indicates the conduct of economic activity and therefore its growth correlates with the growth in economic activity. Where electricity consumption has grown but no growth of the official economic activity has been recorded, this presumably would mean that the electricity has been used in unofficial, *i.e.* unrecorded economic activities.[324]

Each of these methods, however, has its caveats. Empirical surveys and interviews only cover a limited number of market players and therefore do not necessarily provide a full picture of the hidden economy. Econometrical methods based on assessing discrepancies between official GDP levels and expenditures, such as electricity consumption, are based on methodological assumptions, including assumed levels of consumption efficiency and elasticity, and are subject to errors. Nevertheless, results based on such methods may provide

322 According to the study, estimated unofficial activities in Ukraine comprised about 25% of the overall economy in 1992. In the following three years estimates ranged between 47% and 59%. An additional survey conducted in 1994 indicated that about 70% of state enterprise employees or former state enterprise workers were engaged in unofficial activities, from which they derived over half of their income.

323 Similar methods include assessment of discrepancies between national income and expenditure statistics.

324 The authors conclude that during the reviewed period the unofficial economy in Ukraine tripled in size reaching over 40% of the overall economy, while the official economy declined to less than half of its 1989 size. Using the same method, Kaufmann and Kaliberda (1996) estimated that in the mid-1990s, on average, the unofficial economy in CEE ranged between 21% and 24%, while in the FSU it was about 36% to 39% of overall GDP.

some indication of the dynamics of unofficial activities, and indirectly, of the extent of tax evasion as an observable economic phenomenon. However, without providing information about the structure and management of the unlawfully saved income, these methods seem inapt to shed light on the penal law money laundering construction(s).

A study by the Center for Strategic Studies and Reforms (CSSR) in Chisinau undertaken in 1997 used labour market indicators[325] to prove the emergence of hidden economy in the following former Soviet republics: Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan. The CSSR estimated that between 1991 and 1994 the average share of the hidden economy as a per-centage of GDP in these countries almost doubled reaching about 40%. From 1994 to 1997 the size of the hidden economy slightly decreased with about 3 to 5% to its previous level. The cases of Georgia and Uzbekistan presented the two extremes. The increase of the hidden economy in Georgia was the highest, reaching nearly 100% in 1994, and by 1997 decreased to about 60% of the GDP, while the size of the shadow economy in Uzbekistan remained nearly the same throughout the whole period from 1991 to 1997, retaining the level at about 20% of the GDP. However, migration and other demographic factors may distort the picture and lead to errors in the application of this method. Furthermore, as with the above-mentioned methods, it would seem inappropriate for us to try to link the results from such measurement of an observable economic conduct to the legal construction 'money laundering'.

Another indication of the hidden economy is the level of tax evasion, which can directly be linked to money laundering. As unofficial economic activities are largely aimed at evading tax, the amount of tax losses to the state budget can be used to assess the size of the hidden economy. In its study the CSSR reported results from analysis in Moldova for 1997 – first quarter of 1998. According to the CSSR, during this period, tax evasion decreased in the first quarter of 1998, which could mean that the size of the hidden economy also decreased. Similar to other methods, this one is not entirely reliable, as it is not possible to catch all unofficial activities through routine fiscal auditing of enterprises. Besides, *accounts'* fiddling is committed (by its nature) within recorded economic activities with the aim of obtaining illegal monetary advantages. Tax evasion may also take place at the end of perfectly legitimate and

325 The CSSR appears to have based their labour market analysis on a comparison between the offering and demand of labour in a given period and between the numbers of employed at the beginning and the end of a given period.

officially recorded economic operations. It may be that the created value is being registered and the revenues are being recorded but inflated expenses reduce the amount of tax that has to be paid. Such transactions may never be detected and accordingly never taken into account in assessments of the hidden economy. Illicit advantages derived from these transactions are "*canned laundering*" (mentioned earlier, see Van Duyne, 2003b, p. 72), wrapped up in the licit transaction. Therefore they take place in the licit economy, while, in a legal sense, being both part of the hidden and criminal economy.

So we have a conceptual problem: if running a non-registered shop is black economy, then defrauding the tax authorities by inflating expenses and hiding income should qualify as fraud in the registered economy. What construction should be imposed remains a question of debate. Perhaps we should simplify constructions and consider the application of a simple dichotomy: recorded versus unrecorded. And within 'recorded' one has the subset of 'wrongly recorded'. These simple categories cover 'observable conduct'. The rest is after-the-fact criminal or fiscal law (re)construction.

The CSSR also applied official cross-border trade data to assess the amount of unofficial export-import activities. The discrepancies between domestic output and exports of goods can be used as an indication of the existence of unofficial economic activities.[326] However, such analysis should take into account the possibility that some of the exported goods may have been produced elsewhere but have been re-exported from a specific country to benefit from cross-border trade agreements between this country and the country of import.[327]

Once again, it appears difficult to link this method of measuring a sector of the hidden economy to the money-laundering phenomenon, especially when it comes to legitimate goods. One thing to consider is when locally produced legitimate goods remain unrecorded. Another is when export of recorded goods takes place in an illicit way in order to launder money, or to originate proceeds by 'over-exporting'.

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326 The study quotes Romanian data from *Curierul National*, according to which the volume of Moldavian sugar exports to Romania exceeded by 1,8 times (450.000 tons) the officially recorded volume of production of sugar in Moldova. Similar to this is the situation with exports of wine. According to Russian and Moldavian official statistics, exports of sparkling wine from Moldova to Russia exceeded (by 1,6 times) the amount produced in Moldova. Perhaps in this particular case, the term 'criminal' should be used, rather than simply 'unofficial', as the activity described is outright fraud.

327 For instance, the authors of the study noted that part of the sugar exported from Moldova to Romania had in fact been produced in Ukraine, while Vermouth exported from Moldova to Russia had been produced in Hungary and Bulgaria.

Money launderers can use various illegal instruments in international trade and trade finance, such as over- and under-invoicing or over- and under-shipment of goods (see Palmer, 2001; Thanasegaran and Shanmugam, 2007) but that is not quite the same as unrecorded production of legitimate goods. Furthermore, when it comes to re-exporting, there are well-developed VAT fraud mechanisms but that, again, is a different type of conduct consisting of money-making and laundering at the same time, while it can consist of real goods or invoices alone which are passed along the links of the VAT fraud chain. With such multi-facetted economic manifestations, the confusing overlap makes it difficult to distinguish between money laundering, fraud and tax evasion, let alone to measure them. A narrower concept construction would enable us to look into each phenomenon separately (to the extent possible) but that would not be an encompassing concept.

Another indicator of the hidden economy is believed to be the amount of foreign cash in circulation. Firstly, it is observed that market players tend to use cash instead of deposit money and bank transfers in unofficial activities. Secondly, because of high inflation risk, particularly during the early years of transition, businesses preferred to use stable foreign currencies (substitution currencies), usually US dollars or Deutsche Marks, in their market transactions. Šošić and Faulend (2002) have sought to evaluate the dynamics of the 'underworld economy'[328] in Croatia by using the denomination displacement method, which is based on the link between the denomination structure of the local currency and the denomination structure of the substitution currency (Deutsche Mark at the time).[329] The authors note that inflation is a major factor for errors, as due to inflation processes, the denomination structure of currency becomes an unreliable criterion.[330] Besides, even if we accept as fact that high-denomination foreign currency is used in large-scale transactions within the hidden economy, how does this relate to money laundering? Quirk (1996) suggests, as reviewed earlier, that a rise in crime can lead to a fall in official broad money demand and in currency demand as the related proceeds are be-

328 The authors use this term throughout their paper. It cannot be excluded that in their research they have included analysis of both hidden economy of non-criminal nature and shadow activities of criminal nature (elsewhere defined as irregular and criminal sectors).

329 This study refers to the earlier transition period, *i.e.* the 1990s. The authors suggest that in 'dollarised' countries, such as Croatia and Russia, market players largely use high-denomination foreign currency banknotes instead of domestic currency, particularly in large-scale transactions such as the purchase of a car or real estate.

330 Šošić and Faulend also use the electricity consumption method and monetary methods, such as the Gutmann approach, and demonstrate that the use of different concurrent methods can, to an extent, increase the reliability of findings.

ing laundered in parallel financial markets (explained earlier, see section 3.3.1.). However, here again we see concepts from different domains, *i.e.* economic conduct and penal law construction, being mixed up.

Schneider and Enste (2000)[331] point out that hidden economy also exists in the developed market economies. They quote data on the size of the hidden economy as a percentage of GDP derived through the currency demand approach in the OECD countries from 1994 to 1997. The data indicates a slight increase of about 1% from the original level. Over a longer period the increase is significantly larger:

Table 3

Growth of shadow economy relative to GNP
Selected West European countries and the United States, 1960–95

	Size of Shadow Economy		
Country	1960 %	1995 %	Increase in Shadow Economy %
Sweden	2	16	14
Denmark	4,5	17,5	13
Norway	1,5	18	16,5
Germany	2	13,2	11,2
United States	3,5	9,5	6
Austria	0,5	7	6,5
Switzerland	1	6,7	5,7

Source: Schneider and Enste (2000, p. 81), calculations based on the currency demand approach (rounded figures).

Undoubtedly, hidden economy exists not only in transition and developing countries but also in the developed markets, as we have seen above, even to in the most 'decent' economies. However, the hidden economy is believed to be far more considerable in the developing and transition countries.[332] Does this

331 Schneider and Enste (2000) also used data from different sources, obtained through the physical input (electricity consumption) and discrepancy method assessments, to compare the changes in the size of the hidden economy as a percentage of GDP in FSU and CEE from 1989 to 1995. According to their analysis, the general tendency of the hidden economy during this period was to grow and the hidden economy almost doubled in the majority of countries.

332 World Bank former chief economist Stiglitz (2002) observes that the combination of privatisation, liberalisation and decentralisation in the transition countries was expected to lead quickly to a significant production growth but this did not happen. In Poland, Hungary, Slovenia and Slovakia the level of GDP in 2000 remained the same as a decade earlier and in the majority of transition economies the level of GDP actually declined. In Russia, in 2000, it was less than two-thirds of the 1989 level; in Ukraine it amounted to one third of what it was a decade earlier; in Moldova it was less than one third of the GDP level ten years earlier (see Stiglitz, 2002, quoting World Bank data). Stiglitz notes that data on household consumption, *i.e.* how much households spent on food and other living costs, corroborated the decline in GDP level. How-

really mean that money laundering is more considerable in the developing and transition countries? Besides, it is possible that the scope of the hidden economy in developing and transition countries will downscale to the size of the hidden economy in market economies.[333] Does this mean that money laundering will downscale along with the hidden economy? Not necessarily, as in a well-registered economy one needs more money-laundering constructions, while in a loosely regulated economy with many hidden spots, it is easy to slip money unseen into the licit economy. But now we are talking about the narrow definition of money-laundering and about law breaking *conduct* (designing fraudulent constructions) and not about the inconsistent fusing together of two ill-defined concepts: hidden economy and money-laundering.

As we have seen, indicators of the hidden economy cannot reliably be used to prove the existence and to measure the volume of money laundering in economic terms (see Van Duyne, 1994b, for a critical analysis of money laundering assessment methods). There is hardly any bridge between these indicators and the construction of laundering. Therefore, to use the understatement of income by criminals as an indicator of money laundering, as Walker (1995, 2004) suggests (see previous chapters), without using any further refining measurements, will be of little help in providing precise analysis of laundering in the strict sense of the term.

In the next chapter we will review the common perceptions, illusions and reality about money laundering in developing and developed countries.

4.3. The global map of money laundering

This chapter will compare the developing and developed economies in relation to the money-laundering phenomenon. It is generally assumed that the phenomenon is more clearly present in developing countries, given their background and record of corruption, questionable privatisation processes and hidden economy, as opposed to the developed countries which are economically

ever, Stiglitz also admits that many believe the decline in official GDP has been compensated by an increase in barter transactions and unofficial economic activities.

333 The hidden economy is not a static factor. It changes under the influence of changes in the economic environment. The share of the various components of the hidden economy can also change. For instance, a study by Coalition 2000 and Vitosha Research (2005) indicates that between 2002 and 2004 the share of unrecorded employment and non-payment of national insurance in the hidden economy of Bulgaria grew. On the other hand, the share of unrecorded economic transactions in the early to mid 2000s, compared to a decade earlier, has evidently decreased (Coalition 2000 and Vitosha Research, 2005).

more advanced and presumably have a more robust anti-money laundering regime and, therefore, better capabilities to fight laundering. In this chapter we will test the logic of this assumption, examining some of the key arguments pro and against it.

4.3.1. Country classifications

During the Cold War there was a clear divide between the capitalist and socialist countries (as discussed in previous chapters), and between the First World and the Second World. There was also the Third World. The term was coined by demographer Alfred Sauvy, in an article published in the French magazine *L'Observateur* on 14 August 1952, who referred to the poorest countries in the world, especially in Latin America, Africa and Asia, that were unaligned with either the socialist bloc or the capitalist bloc (Quinion, 2005). Now the Third World countries are often called under-developed, developing or industrialising. Many of the former socialist economies are also described as developing or industrialising. There is also the category of 'emerging markets'. The term was reportedly coined in the early 1980s by Antoine van Agtmael, who then worked for the World Bank's International Financial Corporation (Authers, *Financial Times*, 2006). The expression referred to economies with low-to-middle per capita income (as defined by the World Bank) but it quickly came to denote opening and liberalising developing countries in a stage of steady transition to developed economies.[334]

There are different classification methodologies and different views of how we should define the various categories of countries according to the level of wealth and economic development. Some countries may fall into the category of developed economies according to some classifications, but be described as developing markets according to other classifications. Some developing countries might prefer to see a slowdown in multilateral trade liberalisation and to remain qualified as 'developing' in order to keep the preferential trade terms the status entails.[335]

334 In 2003 Goldman Sachs published a report suggesting that the BRIC-like economies (BRIC stands for Brazil, Russia, India, and China) are developing rapidly and by 2050 are likely to outrival the developed economies (O'Neill *et al.*, 2005).

335 The General Agreement on Tariffs and Trade (GATT), formed in 1947, was succeeded by the World Trade Organization (WTO) in 1995. Under a GATT clause, in the 1970s developing countries were given access to the markets of the developed countries without having to lower their own import barriers. These preferences continued to be applied within the WTO. However, within the WTO there has been an increasing pressure on all members to engage in multilateral trade liberalisation. But talks have stalled on several occasions as some develop-ing coun-

The IMF (2008), for instance, has categorised the following 32 economies as 'advanced': Australia, Austria, Belgium, Canada, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Luxembourg, Malta, The Netherlands, New Zealand, Norway, Portugal, San Marino, Slovenia, Spain, Sweden, Switzerland, United Kingdom, the United States of America, and the newly industrialised East Asian Tigers - Hong Kong,[336] Singapore, South Korea and Taiwan.

The World Bank has identified 60 'high income countries,'[337] of which some are classified as developing by the UN (2005). The list compiled by the World Bank includes major tax havens such as the Bahamas, Bermuda, the Isle of Man, the Cayman Islands, the Channel Islands and Liechtenstein.

It is even less clear which countries among the developing economies fall into the category of emerging markets. The online business data provider ISI Emerging Markets lists on its website (www.securities.com) over 80 emerging economies, including Russia and the former socialist block in Central and Eastern Europe, although some of these are included by the IMF and the World Bank in the category of advanced or high-income economies.

For the purposes of this thesis we shall primarily focus on the following broad categories:

- the original members of the FATF[338] (referred hereafter as 'developed', 'advanced' or, in some contexts, 'capitalist' countries) – USA, Japan, Germany, France, UK, Italy, Canada, Sweden, the Netherlands, Belgium, Luxembourg, Switzerland, Austria, Spain and Australia – versus
- the developing countries (former socialist block and the Third World countries[339]) and

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tries have feared that they will have relatively little or no gain from lib-eralisation as they are asked to grant significant tariff cuts while having to face protectionism in developed markets. For instance, as the media has reported, the talks in Seattle in 1999 "*broke down because the developing countries were pre-sented with a lousy deal by the west and were sick of being ignored and patron-ised. Countries like Bangladesh and India walked away from the negotiating ta-ble rather than accept Bill Clinton's idea that core labour standards should be written into trade deals, seeing the move as a form of backdoor protectionism.*" (see report by Elliot in *The Guardian*, 2001).

336 Hong Kong is viewed as a developed economic entity although it is an administrative region of China which is a developing country.

337 World Bank's website, Data and Statistics: Country Groups.

338 As previously mentioned, in 1989 the leaders of the G7 countries, at their Eco-nomic Summit, established the FATF. A number of the FIUs created by some FATF members formed the Egmont Group in 1995 (FINTRAC Annual Report 2003).

339 The description 'Third World' countries remains conditional as some countries in Africa, South America and Asia have also had socialist regimes. Nevertheless, we will use this term for convenience to distinguish underdeveloped countries in Africa, South America and Asia from the former socialist block in Eastern Europe and the former Soviet Union.

- some offshore centres, without aiming at covering every single country.

The reason for such a division is that the original members of the FATF are not only economically advanced (in fact, the world's richest nations) but are also pioneers in the fight against money laundering, *i.e.* they supposedly have a better mechanism for protection against laundering than the rest of the world (or, at least, than the majority of the developing countries or rather, are more worried about the effects of crime-monies, being arguably the major drug consumer countries).

We will focus on these developed countries, on the one hand, and the former socialist block in Eastern Europe and the former Soviet Union, on the other, but will also touch upon some countries further afield.

4.3.2. Background of the developing economies

The former socialist block and the big theft

Since the fall of the Wall, the former socialist countries have come a long way in their transition to market economies. Some of them, like Slovenia for instance (see IMF classification above), are now regarded as advanced alongside major economic powers such as the USA and the UK. But during their transition period, especially the early years, the economic and political state of the former socialist countries was clearly different to that in the developed countries. Most importantly, the former socialist countries were in a process of a major distribution of national assets. "*Because there should be a redistribution of property, there shall be a revolution.*" Chesterton's[340] observation appears quite appropriate to apply to the context of the democratisation reforms in the former socialist block which, if not revolutionary, were clearly fundamental.

What distinguished those countries from the capitalist economies was arguably the need to redistribute a large portion of the national production factors and assets. In order to transform into market economies, these had to be privatised presumably by those with the incentive to manage these assets in the most efficient and viable way. Regrettably, as reviewed in earlier sections, this became a great opportunity not only for people with entrepreneurial spirit, but also for some high-flying thieves to enrich themselves. To use again the words

[340] Gilbert Keith Chesterton, a British novelist. The quotation is from "What's wrong with the world" by Chesterton.

of Chesterton: "*Thieves respect property. They merely wish the property to become their property that they may more perfectly respect it.*"[341]

The opportunity to grab a piece of the national wealth under the cover of privatisation was an opportunity not only to steal but also launder at the same time. Firstly, because tainted money could flow into the economy, specifically through privatisation, without any adequate checks of the origin of the funds. Secondly, because even when money was clean, if the privatisation deal was unfair and corrupt, the acquired assets would have been tainted by corruption but the deal would have largely remained unchallenged.

Institutions such as the International Monetary Fund preached quick privatisation, despite the economic instability in the countries of transition and the lack of a strong legal framework ensuring privatisation's transparency, fairness and efficiency. Corruption in these countries was far more rampant than in market economies (perhaps with some few exceptions such as, notoriously, Italy) but the real danger of corruption was at that stage neglected. In the following years, after the collapse of the socialist regime, many questioned the legitimacy of privatisation. As Stiglitz (2002, p. 58), a one-time World Bank insider, observes, "*privatization has made matters so much worse that in many countries today privatization is jokingly referred to as 'briberization'.*"

During the transition years public procurement has been a particularly vulnerable area with state officials being tempted to manipulate the law and distribute contracts in a non-transparent way among their cronies.[342] In this sector violations of the law can be so well hidden that the gain from corruption will practically become instantly laundered. As a result, parts of the criminal economy become part of the state and family household, and so does laundering, losing its distinctive meaning. Ill-gotten assets can still be questioned at some point, if their owner happens to side with the wrong power clique, *i.e.* it is often a matter of internal power politics whether corrupt conduct will remain unchallenged (for example, Serbia did not fare much better, see Pesić, 2007).

There is no doubt that during the years of transition some national assets were acquired in an unfair and non-transparent way (as reviewed in more detail

341 A quotation from "The Man Who was Thursday" by Gilbert Keith Chesterton.

342 In Bulgaria, for instance, one can take a look at the public procurement contract registry to see clear signs of striking irregularities. In addition to public procurement and EU funded projects (including EU rural and farm aid) as well as privatisation, the media has also reported on corrupt practices in relation to land swaps in Bulgaria. In 2010 the media reported that the swaps of state land (largely forests) for fragmented low-quality private land "*were one of the most intolerable form*" of corruption in the preceding four years and cost Bulgaria some 8 billion levs ($5.74 billion) in losses (paragraph 9, Tsolova, *Reuters News*, 3 February 2010).

in earlier sections), but the majority of these dealings are now apparently irreversible. Due to the high level of corruption and manipulation of the law at the time, it is now hard to prove their illegitimacy. In addition to that, a large number of those who took advantage of the lack of rules or broke the existing ones and became involved in corrupt practices and criminal activities, sought to gradually legitimise their business and become 'decent' businessmen. This applies not only to the big and sophisticated earners who benefited from corrupt practices in privatisation but also to the ones who were involved in less sophisticated crimes. Thus, having started with a revolution, the transition period turned into an evolutionary financial cleansing, a process of mixing legitimate with illegitimate business and conveniently smoothing the irregularities of the early transition years (the process of gentrification, discussed earlier in this thesis). Even though the business of a number of these 'transformed' businessmen may have retained some criminal elements, it is now largely viewed as legitimate. A significant number of the corruptly (or unethically) privatised companies have been subsequently sold to reputable foreign investors, thus leaving no chance for law enforcement authorities to retrace the initially invested tainted money. All is well that ends well.

Other emerging markets and Third World countries

Similarly, Third World countries have also suffered and continue suffering from widespread corruption. Many of them have been torn by civil wars for years. For many, wars such as in Sierra Leone became a way to profiteer (see Smillie *et al.*, 2000). Armed conflicts in Congo, Eritrea, Ethiopia, Somalia and Sudan have created opportunities for abuse of natural resources (Mwenda, 2003). But, while the majority of the former socialist countries are now economically more advanced and are well underway with enforcing modern financial control systems, many of the Third World countries, especially in Africa, still seriously lag behind others, both in terms of economic progress and institution building. Consequently, the fight against corruption remains seriously hindered. Although anti-corruption laws and bodies have been put in place in many of the African countries, critics continue to see "*a wide gap between governments' anti-corruption rhetoric and the impunity enjoyed by public officials*" (Alabi, 2003, p. 215). Privatisation across the region, specifically in West Africa, has been flawed by opportunities for large-scale corruption (see Alabi, 2003). Nigeria was on the FATF non-cooperative countries blacklist until mid-2006 (being listed in 2001, see FATF, 2007). African countries were among the last ones to set up financial intelligence units. Given the usual non-transparent way of functioning of governmental institutions in many of these countries, one may wonder what the term 'suspicious transaction' would exactly denote. Retrospectively, it is not surprising that approximately five years ago cocaine traders diverted their risky direct transport route through Europe instead to pass through West Africa (Van Duyne and Levi, 2005). It would appear that this diversion hardly met any resistance, given the state of law enforcement and the corrupting additional income for the locals hired for aiding the process.

Poverty stricken countries in South America and Asia not only suffer from corruption but are also major producers of drugs. Economic instability and corruption fuel widespread social unrest in South America (see Herrera *et al.*, 2003).

Governments in Asia have sought to tackle corruption but the problem remains a major issue in local politics (see Bolongoita, 2003; Singh, 2003). For a number of years Indonesia, Myanmar (Burma) and the Philippines were blacklisted by the FATF. In fact, military-ruled Myanmar was the last country to be de-listed by the FATF in 2006 (see FATF, 2007). One may wonder whether that was for good reasons or whether it was politically motivated. At the moment (as of January 2011) there are no non-co-operative countries and territories (NCCTs) on FATF's list. However, in 2008, the FATF issued a series of statements expressing concerns about what it viewed as 'deficiencies' in the anti-money laundering/counter-terrorist financing (AML/CFT) regimes of Iran, Uzbekistan, Pakistan, Turkmenistan, São Tomé and Principe, and the northern part of Cyprus.[343] As there is little empirical research into this matter, it remains an issue as to how and to what extent the black-listed countries and those described as having 'deficiencies' suffered from this 'name and shame' policy (see Sharman, 2006, for relevant considerations). It is unclear what happened in the world of observable money laundering transactions after the point of de-listing. Should the de-listing mean that there is now less laundering in those countries than before or have their anti-money laundering regimes become more efficient? Was it only a matter of enacting the requested legislation, setting up an FIU and some additional tokens of outward compliance? Indeed, the FATF is exerting immense foreign policy leverage, through its peer pres-

343 On its website the FATF states that most of these jurisdictions have since then taken some steps towards implementing AML/CFT systems. It further states that in June 2009, the FATF adopted new procedures for identifying non-cooperative and high-risk jurisdictions and started the process of reviewing the AML/CFT regimes of a limited number of jurisdictions. After reviews are completed, jurisdictions found to be high-risk or non-cooperative will be publicly identified (FATF's website, "Identifying and responding to the threat of high-risk jurisdictions", accessed 31 January 2011).

sure reviews, ensuring compliance to its recommendations (even if only outward compliance). However, it is doubtful that the FATF can vouch that dirty money is not being laundered in those tax havens that the FATF has considered less of a concern, or in the developed markets that appeared to have never been a concern to the FATF. But have the developed countries achieved immunity to money laundering and dirty money? We will touch upon that issue in the next section.

4.3.3. Developed v. developing economies and something in between

Do all the observations above mean that developing countries have provided a vast range of possibilities to launder on a massive scale? Are the developing economies more attractive to launderers than the developed market economies?

Despite extensive research into crime trends in both developing and developed economies, the evidence of money laundering activities is anecdotal. It is hard to prove that money laundering in any of the developing countries has been more or less than in any of the developed countries. This uncertainty is magnified by what we remarked earlier about the definition confusion, resulting in the observation that any involvement in business in developing countries with their shadow economies is largely tantamount to laundering.

The exposure to tainted money would presumably be significantly higher in an environment that lacks a strong legal framework, reliable institutions and is prone to corruption. And *vice versa*: it should be lower in countries that have a robust anti-money laundering and anti-corruption regime. However, case studies carried out by financial intelligence units, the FATF and other organisations, indicate that money laundering takes place in transition and developed market economies likewise. Given the profit-oriented crime rate, one would hardly expect something else. But this concerns the whole range of financial crime-money involvement, including the daily receiving and spending of crime money. Things are different when one looks for an accumulation of capital, with the accompanying laundering and investment risks. In fact, there is a reason to believe that many money launderers would prefer the environment of the developed countries. The clean appearance of crime money gained in developed countries would be far trustworthier than in any developing country. Besides, black money owners prefer efficient and reliable banks like any other businessman (Harvey, 2005; Van Duyne *et al.*, 2005). Tainted money does not necessarily behave any differently from white money: both avoid instability and regulators and both seek a good return on their investment. The money of the former head of state of Nigeria, the late Sani Abacha, has been no exception.

Let us look at China as an example. It is a country still dominated by a one party regime, but in many respects it functions as a market economy. It has gradually opened its economy to foreign investment. Goldman Sachs' study describes China as a BRIC economy, *i.e.* an emerging market that steadily transits into a developed country (O'Neill, 2005). Yet in some respect we can also compare it to the 19th-century-Charles Dickens' England, where exploitation of cheap labour was largely regarded as inevitable. But is China a money laundering resort for crime-money from 'good countries'? China has been criticised for 'laundering' illegally derived materials such as timber (see earlier comments in section 3.1.14.). Generally, notoriously high levels of corruption help generate crime-money and, at the same time, provide laundering mechanisms. As reported in the media, according to a March 2006 report of the US Bureau for International Narcotics and Law Enforcement Affairs, the majority of money laundering cases in China involve proceeds from corruption (Bureau for International Narcotics and Law Enforcement Affairs, 2006; see also Lees, *World Politics Watch Exclusive*, 5 October 2006). The report quotes IMF's estimates that laundered funds in China "*may total as much as $24 billion annually*" (p. 129). Notably the report highlights that money laundering in China is also largely connected to tax evasion and that Hong Kong-registered companies play a major part in such schemes. In its report (2006, see also the latest report of 2010) the US authority has included China in the category of 'Jurisdictions of Primary Concern' with regard to money laundering. The three categories defined in the report are: 'Countries/Jurisdictions of Primary Concern'; 'Countries/Jurisdictions of Concern'; 'Other Countries/ Jurisdictions Monitored'. Jurisdictions of Primary Concern are those that are identified as "*major money laundering countries*" (p. 30 of the 2010 report). Remarkably, Austria, Australia, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Switzerland, the UK and the US also feature in the same category (with Belgium listed in the second category and Sweden in the third one). It appears that the US authorities have acknowledged the fact that staggering amounts of tainted money are floating into advanced economies from different parts of the world, including Nigeria, Bulgaria, Russia and China (of which, notably, only Bulgaria is in second category, whereas Nigeria, Russia and China are in the first one). The report, however, notes: "*the focus in considering whether a country or jurisdiction should be included in this category [Jurisdictions of Primary Concern] is on the significance of the amount of proceeds laundered, not of the anti-money laundering* *measures taken. This is a different approach taken than that of the Financial Action Task Force's Non-Cooperative Countries and Territories (NCCT) exercise, which focuses on a jurisdiction's compliance with stated criteria regarding its legal and regulatory framework, international cooperation, and resource allocations*." (p. 30 of the 2010 report).

Bad money goes to 'good countries' but the 'good countries' evaluate the 'bad countries' and exert pressure on them. Over the years it has clearly transpired that the 'good countries' apply double standards which has led to the absurd situation of prejudiced treatment against the 'bad countries,' while 'good countries' serve as laundering destinations too. Requirements for public disclosure of corporate information (which is so important for due diligence purposes in financial transactions) allow a convenient corporate veil in many places like the US state Delaware and Dubai. However, who would dare to say those places should be avoided for a high money laundering risk? As an article in *The Independent* noted in 2004, when Guatemala was removed from the FATF list, "*[t]he total [of blacklisted countries] is down from 30 in the 1990s and 15 in 2001, though why Dubai - considered by many to be the world's main money-laundering centre - is not on the list remains a puzzle to many financial services experts*" (Lashmar, 2004).[344]

There is evidence that the United States itself is often used as a money-laundering destination for, *inter alia*, Chinese tainted money.[345] When, in 2006, the Chinese authorities arrested Chen Liangyu, Bangkok-based British journalist Graham Lees reported that financial investigators from the West wondered whether the trace of Liangyu's money would lead to the United States. Chen was the party secretary of the Shanghai Municipal Committee of the Communist Party of China and was alleged to have been involved in corrupt practices, including a social security fund fraud scheme. Following Chen's arrest, investigators revealed that a large portion of the dirty money from that particular scheme and other crimes was leaving via Hong Kong. The US was confirmed as one of the favourite destinations for laundering (Lees, 2006). According to *Xinhua* news agency (quoted by Lees, 2006), the USA was the main destination, among 14 countries, for a $5,2 billion embezzlement by forty senior offi-

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344 Similar to Delaware, Dubai is somewhat of a state within a state in the UAE. In 2001, 16 jurisdictions, including the UAE, were referred to FATF's NCCTs process and were reviewed in two rounds, but the UAE was not identified as NCCT (FATF, 2007), despite the lax corporate disclosure regime in Dubai.

345 The problem of brand piracy in China raises an interesting question: what happens with the ongoing laundering that brand piracy produces which appears to be tolerated by the Chinese authorities and, apparently, is orderly integrated in the Chinese GDP?

cials. Investigators estimated that 21% of the money was 'washed up' in the USA. Hong Kong-based lawyer and risk management advisor Peter Gallo is quoted by Lees commenting that "*the money, like the people who took it, are attracted to the more sophisticated economies, and the anti-money laundering efforts of the financial industries in those jurisdictions do not appear to be a deterrent.*"[346] Gallo has further noted: "*Despite all the usual assurances from the private banking industry, even in a highly regulated environment like the US, the [post 9/11] Patriot Act had little effect on the private banking industry.*"[347]

Similar to China,[348] Russia has also seen staggering amounts of tainted money leaving the country and flowing to the West, specifically to the US. The Bank of New York scandal (previously mentioned) is an example and it does not stand alone. Russia has severely suffered from all the dangers that can be brought about by inadequately regulated transition and *impromptu* privatisation processes. Media reports and research papers, including a study by Solongo, a staff member of the United Nations Office for Drug Control and Crime Prevention (Solongo, 2001), indicate that (as discussed in previous sections), in the 1990s, capital flight from Russia was significant and that it was likely to be largely related to money laundering (which, under the broad definition of laundering, is quite feasible). Solongo observes (2001, p. 1) that during the transition period, Russia offered "*a golden opportunity for those seeking to acquire huge assets rapidly by criminal actions while remaining undetected or under arrangements the criminality of which is hard or even impossible to prove.*"[349] However, despite widespread corruption and criminality in Russia, Solongo admits (2001, p. 4) that Russia has been largely perceived "*as a source of illicit proceeds, rather than their safekeeping haven.*" As previously discussed, during the 1990s grand embezzlement, massive asset stripping and tax evasion were prevalent. A large portion of the criminally derived proceeds was transferred abroad. As Solongo notes, Russia offered a good 'placement' opportunity.[350] After the placement stage, however, money had to be wired across border, often to offshore jurisdictions or developed countries in the West, in order to undergo what is generally called 'layering' and 'integration' (reviewed in earlier sections). Solongo

346 Paragraph 5 (the article was derived online and no page number is available).

347 See the last paragraph of the article.

348 See Schulte-Kulkmann, 2007, for analysis of recent anti-money laundering developments in China.

349 As previously discussed, certain aspects of the legal framework in Russia were so weak that even if flagrantly unethical, on many occasions highly contentious business actions were not necessarily criminal, according to the letter of the law.

350 At least for local crime-money, as Western criminals may not have dared to place their money in Russia.

states that according to Russian prosecutors and law enforcement representatives, the criminal proceeds were usually taken outside Russia and criminals themselves often found a safe haven abroad. They further argue, as Solongo's study indicates, that "*the misapprehension of the political realities in the Russian Federation by the foreign authorities often play into the hands of criminals, who manage to obtain from these authorities decisions on their non-extradition or political protection*" (Solongo, 2001, p. 16). As a result, Russian authorities were often unable to locate or, if located, to confiscate the proceeds.

There is hardly a comprehensive study on the extent and specifics of investment (who, when, where and how it has progressed), in the West, of tainted money from Russia or other emerging and developing countries. However, Solongo and various media sources cite a number of examples where individuals associated with controversy in their home country have managed to set up companies in 'decent' jurisdictions such as the USA. Solongo mentions that Russian banker Alexandre Konanykhine, whom the Russian prosecutors wanted to be extradited from the US to Russia to stand trial for financial crimes, was granted political asylum in the US.[351] Solongo also refers to Semyon Mogilevich, the Ukraine-born alleged leader of the Russian underworld (previously mentioned), who, despite his notoriety, appears to have managed to set up companies in the USA, Canada and elsewhere relatively unimpeded until some of his operations attracted intense attention from the authorities.[352] Regardless of whether Mogilevich or others have been proven guilty, their money was associated with some controversy and yet it slipped through the anti-money laundering system of the West. As Solongo (2001) and Shelley (2000) note, developed countries become richer benefitting from the flows of

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351 According to media reports, since arriving in the USA with his wife in 1993, Konanykhine "*has lived a life of extremes*" having gone "*from being a jet-setting Internet banker with an apartment in the Watergate and matching his-and-hers BMWs, to a prisoner, to a political refugee, to a successful businessman again and back to a prisoner, awaiting deportation*" (Farah, *The Washington Post*, 2004, paragraph 4). When Konanykhine went to the USA in the early 1990s, he reportedly introduced himself as the US vice-president of Menatep Bank (*Evening Standard*, 2005). This is the very same bank the owner of which, Mikhail Khodorkovsky, was imprisoned for financial crimes, including tax evasion, in Russia (as previously mentioned). Interestingly, as noted in the *Evening Standard* (2005, paragraph 2), the US authorities have exhibited a level of hypocrisy having "*condemned the prosecution of Khodorkovsky, accusing Russia of 'backsliding' on democracy*" while at the same time investigating him for suspected money-laundering involving the Russian mafia and ex-KGB officers.

352 Solongo notes that he has been investigated in a number of jurisdictions, including in relation to allegatons that he defrauded stock investors through his YBM Magnex International, Inc. (a company incorporated in Canada, but headquartered in Newtown, Bucks County, Pennsylvania, see Offshorealert, 2003).

tainted capital coming from the developing and transition countries, including Russia.

Bulgaria has suffered similar problems. As mentioned in earlier sections, both clean and tainted money from Bulgaria was channelled to other countries on many occasions and for different reasons, ranging from unwillingness to pay taxes to the need for full scale laundering. In earlier sections we reviewed the phenomenon of 'red capital'. Party funds allegedly embezzled by leaders of the former regime were transferred abroad to later return (at least partly) to Bulgaria as legitimate and largely presented as 'western' capital to be invested in the Bulgarian economy. An extensive number of companies in the West were either newly set up or bought off-shelf to be later used as a vehicle for currency transfers. The West accepted this money not only from senior representatives of the regime, but also from proxies, front men, and from alleged mobsters and controversial businessmen, such as Konstantin Dimitrov (see previous sections), who were able to open accounts with reputable banks and buy property in the UK, the USA and other highly regulated jurisdictions. The late Konstantin Dimitrov, for example, who is alleged to have earned his fortune through racketeering, contraband and drug dealing, has reportedly left to his widow properties in London worth over €3,2 million, including five luxury shops and a flat in one of London's most affluent areas, South Kensington (Iliev, *Standard News*, 2008).[353]

Western countries are a favourite destination also for tainted capital from Africa. As mentioned earlier in this thesis, Nigerian corrupt officials transfer most of their ill-gotten wealth outside the country, primarily to the UK. Peel (2006) quotes a senior Nigerian law enforcement officer saying that approximately 90% of Nigerian state governors have property in the UK and accounts in their, or family members, names. According to him, the majority of the money flowing from Nigeria to Britain is "*government-related [. . .] corrupt money being laundered*" (Peel, 2006, p. 19). At a meeting of the Commonwealth Parliamentary Association in June 2002, Nigeria's then President Olusegun Obasanjo noted that funds stolen from the treasuries of developing countries hide in the financial institutions of the western world (Alabi, 2003).

353 As discussed, in earlier sections, after Dimitrov's murder in Amsterdam in 2003, the Bulgarian authorities sought to trace and seize his assets. This included assets held in London. However, it appears that the UK authorities were not as co-operative as the Bulgarian authorities had expected. The media reported that after initially imposing a freezing order on the widow's flat in March 2007, several months later, the UK authorities returned the flat to Dimitrov's widow. Representatives of the Bulgarian authorities were quoted as saying that they would request an explanation from their UK counterpart as to the reasons for that decision (*BgVesti*, 2007).

However, we would hardly read about such property transactions in the annual reports of the FIUs from the 1990s and early 2000s. Now that international regulations belatedly require enhanced know-your-customer scrutiny into Politically Exposed Persons (PEPs) (see next section) and other high-risk clients, will this be allowed to happen again?

It seems that despite robust anti-money laundering regimes in the West, substantial volumes of tainted money still finds its way into the developed economies. Estimates as to the scope of laundered funds in the developed and developing countries can only be speculative. Indeed, crime-money does not always need to cross borders as it can be used or laundered domestically. After this domestic (usually corruption supported) laundering, it may start to travel abroad, if only to avoid potential expropriation. But it seems that policy makers are primarily concerned about those international (cash) money movements that expose the financial system only of the western world to 'contamination' (and this concern seems to be merely outward appearance, given the benefits developed countries gain from the inflows of capital) or are they rather concerned about developed countries losing capital, regardless of colour or smell? The process of exposure is a two-way street but it appears that the developed countries would rather black-list yet another developing country instead of looking properly into the problems on their own side of the track. Corporate crime and fraudulent accounting practices in the USA have probably generated and laundered tainted funds on a scale much larger than any crime industry (see Dininio and Anechiarico, 2003, for comments on corporate crime and misleading accounting in North America).[354]

Indeed, Enron's fraudulent accounting scam largely relied on offshore subsidiaries to keep its debt profile low (see media reports, including Clark and Carrell, *The Guardian*, 22 February 2008; see also Dininio and Anechiarico, 2003). However, this does not mean that it all has to be blamed on the offshore centres. Policy makers from the West have restlessly insisted that offshore centres should tighten their anti-money laundering regimes. But as a matter of fact, financial centres such as the Isle of Man, Hong Kong, the Cayman Islands and Guernsey, were among the first economies to establish a financial intelligence unit even before most of the FATF founding members (see next section). What should be remembered is that the equation of 'kept offshore' and 'being laundered' has now become debatable. Irrespective of how many accounts (offshore

354 The cases of Madoff and Stanford who were accused of fraud in 2009 revealed a massive scale of alleged fraudulent activities.

or in developing countries) through which the money flows, its appearance may remain open to multiple interpretations. However, as soon as it slips through the financial system of an advanced economy (*e.g.* because a banker has overlooked a 'red-flag', turned a blind eye or has been bribed), its appearance becomes trustworthy, that is, it is 'really' laundered.

We constantly hear about know-your-customer rules becoming tighter and advanced economies becoming more reluctant to work with 'non-cooperative' states or states which have deficiencies in their anti-money laundering regime.[355] Interestingly enough, however, little information is available about the level of efficiency in the advanced countries as regards preventing wealthy tycoons from investing their money of obscure origin in the fancy neighbourhoods of cities in the West, including West London. How many SARs have reached SOCA or its predecessor, NCIS? There are numerous rumours about Russians buying expensive properties in West London, but no official conclusive report about this has been issued. It is unknown whether or how much of the investments flowing from 'bad countries' into the 'good countries' resulted in suspicious activity reports. But there is enough evidence, as reviewed earlier, to suggest that 'good countries' also prove to be 'good safe havens' for 'bad money'.

4.4. The global anti-money laundering war

Over the years the anti-money laundering war, with its integral intelligence gathering system of FIUs and reporting institutions, has risen to unprecedented levels of information collection and dissemination on a global scale. This section will further review the measures imposed on the financial industry and other regulated businesses and will address some of the issues that arise from the regulatory framework, including the Third EU Council Directive of 2005 (2005/60/EC),[356] within which the process of intelligence gathering takes place.[357]

355 On 25 February 2009 the FATF issued a Statement expressing concerns regarding deficiencies in the anti-money laundering regimes of Iran, Uzbekistan, Turkmenistan, Pakistan, and São Tomé and Príncipe (FATF, 2009).

356 Although the EU Directive applies specifically to EU Member States, other countries, where similar regulations have been introduced, face similar challenges as those arising from the EU Directive. As noted in earlier sections, EU legislation was largely based on developments driven by the US.

357 This subject was examined in detail in "On the frontline against money-laundering: the regulatory minefield" (Gelemerova, 2008).

4.4.1. The hit-or-miss approach

By extending the meaning of money laundering, to include the movement and concealment of crime money, policy makers have effectively created a tool for gathering intelligence about predicate crimes (Gold and Levi, 1994). As mentioned previously, critics such as Van Duyne, have on many occasions argued that the authorities have used conveniently augmented figures to expand their powers. However, some could argue that policy makers' effort has been justified by the need to ensure that crime does not pay. Indeed, there is some merit to the anti-money laundering regime with its related 'threat imagery' and that is that it can help gather financial intelligence to identify predicate crimes. However, given the lack of clarity, consistent feedback from FIUs to reporting institutions and the lack of precise criteria for identifying tainted money and suspicious or unusual transactions (Gelemerova, 2008), it remains debatable whether, or to what extent, this tool is useful or has been used efficiently. Indeed, thus far no testable performance measures have been implemented to demonstrate the efficiency and efficacy of this tool. Although government agencies, often jointly with the financial industry associations, seek to provide guidance[358] (*e.g.* in the form of handbooks and typologies) to reporting institutions, in certain cases this guidance remains broad, and, in some respects, impractical.

In 2006 the UK Joint Money Laundering Steering Group (JMLSG)[359] produced a comprehensive guidance manual (later updated)[360] that provides examples of high-risk customers and suspicious transactions, for instance, customers based in (or doing business in) high-risk jurisdictions. Examples also include: corporate customers with complex business ownership structures; politically exposed persons; customers engaged in cash-intensive businesses; the use of non-resident companies in circumstances where the customer's needs do not appear to support such economic requirements; transfers to and from high-risk jurisdictions without reasonable explanation; and unusual investment transac-

358 The FATF, the Basel Committee and other international bodies have also issued guidance at various points on know-your-customer rules and risk management. Available guidance, however, appears to be primarily focused on the banking sector despite the need for more detailed guidance also with respect to other parts of the regulated sector.

359 An industry organisation comprising a number of financial sector trade bodies engaged in providing advisory services on compliance with legal and regulatory requirements and good practice.

360 An updated version of this manual was issued in December 2007. The guidance was issued in two parts: a) Guidance for the UK Financial Sector, Part I, b) Guidance for the UK Financial Sector, Part II: Sectoral Guidance (Joint Money Laundering Steering Group, December 2007; available on the JMLSG website – www.jmlsg.org.uk). Subsequently the guidance manual was revised and updated. Also, Part III was issued in October 2010.

tions without an apparently discernible profitable motive. Examples of transactions that could trigger suspicion in relation to terrorism include frequent international ATM (automated teller machine) activity. Although such examples provide some general guidance, they remain largely vague. It appears, for instance, that staff at reporting institutions may interpret such guidance to the effect that almost any customer from Eastern Europe, Russia or the Middle East could be regarded as a potential risk factor, *i.e.* a potential money launderer, irrespective of the type of transactions they undertake.[361]

The *risk* of money laundering is itself an unclear concept too. Does it relate only to a specific transaction (as more commonly understood) or generally to a customer and his/her activities? For instance, the JMLSG manual interchangeably refers to (a) knowledge or suspicion that a transaction might involve money laundering; and (b) knowledge or suspicion that a customer might be involved in money laundering, which is not quite the same thing (see Gelemerova, 2008).[362] Additionally, money laundering, as defined in international law, is such a broad concept – our continuous theme - that even marginal irregularity may trigger suspicion. In turn suspicion prompts reporting to the relevant FIU. Yet suspicion is also a vague term, "*a variable that depends on different mindsets, subjective judgement and interpretation*" (Gelemerova, 2008, p. 41).

The JMLSG notes that suspicion is indeed subjective and "*falls short of proof based on firm evidence*" (JMLSG, 2007, p. 121). JMLSG's handbook notes that UK courts have defined 'suspicion' as something beyond mere speculation, and based on some foundation, for example: "*A degree of satisfaction and not necessarily amounting to belief but at least extending beyond speculation as to whether an event has occurred or not*"; and "*Although the creation of suspicion requires a lesser factual basis than the creation of a belief, it must nonetheless be built upon some foundation*" (p. 121). On its website the UK Serious Organised Crime Agency (SOCA), which incorporates the UK FIU, refers to R v Da Silva [2006] All ER (D) 131 (Jul) in which the Court decided that suspicion would arise when: "*there was a possibility which was more than fanciful, that the relevant facts existed. This is subject in an appropriate case, to the further requirement that the suspicion so formed should be of a*

361 As an example of poor practice and lack of a "*robust approach to classifying the money laundering risk associated*" with clients, the UK's financial regulator, the Financial Services Authority (FSA), drew attention to a wholesale small firm that classified all of its clients as low or medium risk even though most of them were based in Eastern Europe, North Africa and the Middle East (FSA, 2008, p.12).

362 A customer can be involved in money laundering without the specific transaction being connected to money laundering.

settled nature."[363] The clarification provided by JMLSG and SOCA may be helpful but still leaves a broad scope for interpretation (which, as a matter of fact, is not necessarily a bad thing if it is in combination with clearer criteria for discerning tainted money and for reporting suspicious transactions).

Interpretation and, more importantly, implementation of anti-money laundering measures became an even bigger challenge after the events of 11 September 2001, when the criteria for reporting suspicious transactions were expanded to include transactions that may be linked to terrorist financing (this issue has been particularly highlighted in the Third EU Directive) although it may have little to do with laundering in the strict sense of the term. The result of this is that, in addition to potentially dirty money, reporting institutions now have to be able to identify clean money that may be used for terrorist financing.[364] However, how to effectively implement this in practice remains an issue. The little guidance that has been provided (the situation varies across countries) remains broad. It is generally advised, as a matter of due diligence, to search national and international blacklists and sanctions lists to check whether names of customers or potential partners appear on such lists. However, it is not clear whether this is sufficient and how connections to 'countries of risk' should be treated (see Gelemerova, 2008). It appears that particular ethnic or national groups could potentially become targets of constant suspicion and scrutiny (see Gold and Levi, 1994).

Additional challenges arise from the implementation of the requirement of the Third EU Directive in relation to the identification of domestic or foreign Politically Exposed Persons (PEPs).[365] For instance, with regard to PEPs in other Member States or third countries, Article 13 of the Third Directive requires reporting institutions to take adequate measures to establish, *inter alia*, the source of funds involved in a specific business relationship or transaction. This means, first, that reporting institutions have to establish whether or not a customer is a PEP; and, second, they have to undertake further research in order

363 SOCA notes that in K Limited v National Westminster Bank plc (HMRC and SOCA intervening) [2006] All ER (D) 131 (Jul) the Court has decided that this definition should apply in both criminal and civil cases. See SOCA, "Frequently asked questions (FAQs)", subsection "Q. What is Suspicion?").

364 For instance, in some circumstances charities can be used as a front for (or vehicle of) terrorist financing: banks that carry out financial transactions involving, or on behalf of, charities may find themselves in a situation which necessitates that they report to the relevant FIU; however, banks may overlook important underlying risks due to the lack of sufficient and clear guidance in existing regulations.

365 According to the Directive (Article 3 [8]), PEPs are "*natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons*".

to determine whether the PEP's funds have a legitimate origin (something that even the police and tax authorities may have difficulty establishing). It appears that due diligence checks which are aimed at identifying PEPs can be used as a tool to gather intelligence on potential white-collar crime and tax evasion, which also entails intelligence on the subsequent money laundering. However, the lack of standards and consistency in applying due diligence measures across institutions and countries ultimately means that intelligence, if any, will be gathered largely on a hit-or-miss basis. It is plausible that if the main 'fish' being caught will be of a fiscal nature, the provision will in the end develop into an international tax-evasion intelligence collecting instrument. The Directive attempts to provide some guidance on due diligence but it remains too broad (see for more details Gelemerova, 2008).[366]

According to the EU Directive, risk is generally higher in countries where corruption is endemic (see section 4.4.3. on considerations concerning corruption issues and money laundering). Apparently the European Commission assumes that reporting institutions have existing knowledge about the political environment in the countries of residence of their customers which is not necessarily the case (see Gelemerova, 2008). It appears that almost any customer who comes from an emerging market country and is a PEP, or is associated with a PEP, can be viewed as a potential money launderer. The implementing measures directive (2006/70/EC) clarifies that after an individual has ceased to exercise a prominent public function, subject to a minimum period, this individual is no longer to be regarded as a PEP (point 5 of the introduction). The directive further stipulates that "*without prejudice to the application, on a risk-sensitive basis, of enhanced due diligence measures, where a person has ceased to be entrusted with a prominent public function [. . .] for a period of at least one year, institutions [. . .] shall not be obliged to consider such a person as politically exposed*" (Article 2, paragraph 4, p. 32). In reality, however, this can be interpreted to the extent that in certain circumstances, on a risk-sensitive basis, some individuals can be regarded as PEPs even after a year has elapsed. As previously noted, in emerging markets, politics and business are closely intertwined. Thriving businessmen, some of which are former politicians, often maintain relationships with current politicians, *i.e.* PEPs, as a way of guaranteeing support for their own

366 For instance, if 'complete normal customer due diligence measures,' prescribed in the Directive, imply the necessity of establishing and verifying the identity of any given customer, it remains unclear how far beyond that point reporting institutions should go in applying 'enhanced due diligence measures'. Additionally, the category of PEP also includes immediate family members or close associates of a PEP, even though it may prove difficult to establish whether a customer is related to a PEP, unless the customer explicitly declares that such a relationship exists.

interests. This ultimately means that former politicians and/or legislators turned businessmen can also be viewed as PEPs in certain situations, on a risk-sensitive basis (Gelemerova, 2008).

Given the lack of clearer criteria, it appears that both financial and non-financial reporting institutions are prepared to work with PEPs and their associates if these are relatively wealthy and do not seem to be outright criminals. As a matter of good risk management practice reporting institutions, specifically banks, should know all potential transaction risks, political risks, reputational risks and so on, that may be associated with their customers. However, it is not very clear whether and when money laundering/terrorist financing risks have to become a deal-breaker and, more importantly, to trigger submitting a SAR to the relevant FIU. The whole due diligence industry has been largely driven by anti-money laundering 'know-your-customer' legislation[367] and fear of related sanctions. Yet it has been built on an unstable basis of subjective principles that leave scope for interpretation. An important question, for instance, is whether the wealth of newly defined 'legitimate' businessmen, including in some instances PEPs or those formerly involved in questionable activities, is still in some way tainted (the 'crime-money heritage' question).

It remains an issue how seriously a reputational concern should be taken when it arises from historical controversies (especially given that with regard to a specific crime the relevant statute of limitations may have expired or the crime has remained unproven). As mentioned earlier, the process of cleansing or gentrification of wealth demonstrates a tendency of reconciliation with such reputational concerns, regardless of the ethical and moral implications. Clearly if a potential risk exists, this does not necessarily mean that a specific transaction is suspicious or that the customer is a money launderer. However, in the absence of clear standards and precise criteria, and most importantly, given the broad definition of money laundering, it is difficult to make judgements and to strike balances (see Gelemerova, 2008).

According to Séverine Anciberro, a representative of the European Banking Federation, the EU should be considered a single jurisdiction and PEPs from EU Member States should be regarded as domestic PEPs because credit institutions in Member States are already implementing relevant due diligence procedures (Anciberro, 2005). Anciberro notes that the banks in Europe would have preferred if PEPs were regarded as a risk factor only in cases where transactions

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367 As discussed elsewhere in this thesis (see section 4.4.3.), legislation against the bribery of foreign officials and other laws, regulations and restrictions are also increasingly becoming a major driving force behind the development of due diligence practices.

were particularly substantial or complex[368] in nature, thereby posing enhanced money laundering and reputational risks. Such an approach would necessitate the undertaking of enhanced due diligence investigations only in circumstances where PEPs appear to have engaged in a suspicious transaction. The Federation's proposal, however, was not adopted, even though the proposal made perfect sense. Yet one major problem affected the logic of the proposal: the consistency in applying due diligence measures, not only across countries (even within the EU) but also across economic sectors and reporting institutions within one specific jurisdiction, remains an issue.

Considering the way the anti-money laundering system has been designed, it is difficult to determine whether some reporting institutions are diligent at all and whether within other institutions due diligence work is being taken to excessive extremes. There is a distinct lack of a standard approach and consistency as well as of effective evaluations of due diligence procedures and their effects across industries and jurisdictions. The same applies to risk assessment. Even within one specific institution risks may be viewed differently. While a qualified anti-money laundering officer may feel it necessary to warn of potential reputational and regulatory concerns associated with their clients, officers on the private banking side may be less concerned about these issues and press for the deal to go ahead. This is often the case where it is difficult to verify or prove reputational concerns, particularly those that are based on rumours. Presumably it would not be necessary to report to the relevant FIU if the concern was based on mere speculation. However, there is scope for interpretation on this point (Gelemerova, 2008).

As previously noted, it appears that the due diligence industry is increasingly driven by legislation and the fear of sanctions rather than by the rational need for sound risk management practices. The ultimate result of the general fuzziness of criteria and guidelines for due diligence reporting is that FIUs and their regulatory partners are unlikely to be receiving the quality intelligence from reporting institutions that they expect.

Banks have also noted that other challenges posed by the Directive arise from the requirement to identify beneficial owners[369] and not to engage in correspondent relationships with banks known for allowing their accounts to

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368 This ultimately means a transaction that is complicated and not straight-forward and therefore requiring closer scrutiny. Such transactions may appear non-transparent, *e.g.* structured in multiple layers and involving a number of obscure offshore entities.

369 Beneficial owners are those wielding ultimate control over the customer and/or the individual or entity on whose behalf a transaction is conducted. The Directive requires establishing the identity of beneficial owners holding over 25% of the shares in a business.

be used by a shell bank(s). Anciberro (2005) stresses that the obligation to know the customer's customer is generally not workable, specifically with regard to correspondent relationships. Sound risk management practices conform to this requirement in any event but, in some cases, it might be difficult to verify the identity of the ultimate owner. Even where sound risk management practices aim at identifying the beneficial owners, such identifications may be based on unsubstantiated information. European banks have expressed their concern that reliable and independent sources of information are not always easily accessible to banks (Anciberro, 2005). The availability of public records, including information on ownership, varies widely within the EU and across the world.

In its guidance the JMLSG stresses that firms should encourage their staff to "*think risk*" (JMLSG, 2007, p. 9). The JMLSG appears to appeal to individuals' common sense, intelligence and motivation. Certainly individual commitment and care are of significant importance. However, "*the need for 'quality intelligence' also requires a clear basis for developing shared standards that ensures optimal objectivity and consistency in decision-making*" (Gelemerova, 2008, p. 41).

It appears that in a joint international effort to fight money laundering, policy makers have laid down requirements, while providing insufficient practical guidance as to how to implement them. The approach to be adopted in all these matters is apparently to be largely defined by the reporting institutions themselves on a discretionary basis. Even if reporting institutions diligently undertake enhanced due diligence research, it remains an issue at what point, and under what circumstances, does the gathered information become useful intelligence for regulators. Due to insufficient feedback from the regulators as well as law enforcement agencies (police and prosecution), this question cannot be answered. The demand of transparency is not heeded by those who demand it in the first place.

4.4.2. The AML risk: how much of it is too much?

The Third EU Directive calls for a risk-based approach. It requires enhanced customer due diligence in situations of a higher risk of money laundering and/or terrorist financing. It also requires the implementation of adequate measures to compensate for the higher level of risk in situations in which the customer has not been physically present for identification purposes. The Directive stresses that reporting institutions should apply enhanced due diligence on 'a risk-sensitive basis' but it appears that each institution can decide for themselves when, and to what extent, to undertake in-depth due diligence.

The banking industry in the EU has generally approved of the introduction of the risk-based approach (Anciberro, 2005). The European Commission (Commission Staff Working Document, 2006) has admitted that even prior to the introduction of the Third Directive many reporting institutions had been adhering to such risk-based practices in non-face-to-face identification procedures. It is believed that if aptly applied, the risk-based approach can help to better focus resources and avoid costs not commensurate with risks.

Developments in the EU mirror developments in the US where the risk-based approach has become important as well. FinCEN's director, James Freis, notes that matching risk-based examination to risk-based obligations helps achieve regulatory efficiency and better organises the allocation of examination resources (Freis, 2007). This can be considered a response to the complaint that, for instance, compliance in the money service businesses (MSBs) in the US has led to a significant increase in costs. McClain (2007) has stressed that MSBs bear the cost of the US BSA enforcement strategy and that compliance with Suspicious Activity Report (SAR) and Currency Transaction Report (CTR) requirements has led to direct and substantial costs, not just in the MSB industry, but also across the entire financial services sector. This in turn has led to higher fees charged to customers.

Given the high cost of compliance, the move to a risk-based approach, *i.e.* ultimately less prescription, was generally welcomed because nearly all other prior changes in the anti-money laundering system had largely led to over-regulation and over-compliance, with little or no evident decrease in purported money laundering. For illustration, tables 1 and 2 (below) indicate that the overall number of suspicious transactions reports submitted to the FIUs of several countries has increased over the years, specifically since 1994 and prior to the recognition of the risk-based concept by the Third Directive (in some countries peaking in 2002 following the terrorist attacks of 2001).[370] According to McClain (2007), regulatory pressures in the USA, in the absence of clear guidance, have resulted in a large number of defensive SAR filings and duplicate CTR filings. He also notes that the volume of suspicious transaction reports places a burden on government agencies, specifically FinCEN, as it has to processes a large amount of data of dubious value as a result. Specifically, McClain notes that in the aftermath of 11 September 2001 increased regulatory scrutiny led to defensive SAR filings which reported even marginally irregular activity.

370 The tables were also presented in Gelemerova (2008) where the subject was discussed in detail.

Table 4[371]

Statistics of suspicious transaction reports by jurisdiction
Number of Suspicious Activity Report Filings by Year
in some European Countries

State	1994	1995	1996	1997
Belgium	2.183	3.926	5.771	7.747
Germany[372]	3.282	2.935	3.289	
France	684	866	902	1.213
Netherlands – unusual – suspicious	 14.753 3.546	 15.007 2.994	 16.087 2.572	 17.000
UK	15.007	13.170	16.125	14.148

Source: European Commission, 1998

Table 4 (continued)

States	2002	2003	2004	2005	2006
Belgium	13.120	9.953	11.234	10.148	9.938
Germany	8.261	6.602	8.062	8.241	10.051
France	8.719	9.019	10.842	11.553	12.047
Holland – unusual – suspicious	 137.339 24.741	 177.157 37.748	 174.835 41.003	 181.623 38.481	 –
UK	56.023*	94.718*	154.536*	195.702	21.3561

Source: FIUs' Annual Report(s)
* Source: Van Duyne *et al.*, 2007

Table 5

Number of Suspicious Activity Report Filings by Year in the USA

Institution	1996	1997	1998	1999	2000
Depository Institution	62.388	81.197	96.521	120.505	162.720
Money Services Business	–	–	–	–	–
Casinos and Card Clubs	85	45	557	436	464
Securities & Futures Industries	–	–	–	–	–
Subtotal	62.473	81.242	97.078	120.941	163.184

371 As noted previously, all figures in this paper are in Continental European annotation.

372 The 2004 annual report of Bundeskriminalamt, Germany's FIU, provides the following figures: 1994 – 2.873, 1995 - 2.759, 1996 – 3.019, 1997 – 3.137.

Table 5 (continued)

Institution	2001	2002	2003	2004	2005	2006
Depository Institution	203.538	273.823	288.343	381,671	522.655	567.080
Money Services Business	–	5.723	209.512	296.284	383.567	496.400
Casinos and Card Clubs	1.377	1.827	5.095	5.754	6.072	7.285
Securities & Futures Industries	–	–	4.267	5.705	6.936	8.129
Subtotal	204.915	281.373	507.217	689.414	919.230	1.078.894

Source: FinCEN, The SAR Activity Review – By the Numbers (Issue 9, January 2008)

It is evident from these tables that the number of suspicious transaction reports has increased over the years. However, this has not necessarily resulted in better quality reports. Policy makers believe that by applying a risk-based approach reporting institutions will reduce the number of poor quality reports. This will mean that the quality of intelligence provided to FIUs will improve.

Yet the important question of how to identify and assess risks remains pressing. As mentioned previously, not only across countries and sectors but also within a specific institution risks may be viewed differently by the various departments of that institution. Even where reporting institutions are always on the alert and are able to spot risks, they should also be able to decide whether these risks necessarily require enhanced due diligence and/or reporting to the relevant FIU. This means that in the first instance they need to know what exactly 'high-risk' is. In other words, how much AML risk is too much not to report? This implies that a risk-threshold has to be operationalised. However, a general operational risk-threshold does not exist: each financial and commercial sector, as well as jurisdiction, will have a threshold of its own. This means that even within one specific cross-border operation, for instance in trade finance, the parties involved on the different ends, in different jurisdictions, may look upon risks in different ways. Thus, just elaborating on the risk definition is unlikely to alleviate the burden of the financial institutions without any further effort in standardising compliance practices and the necessary resources across countries. And for that standardisation to be achieved account should be taken also of specific contexts.

Indeed, by standardising we should by no means hope to achieve a universal program of measures that can be applied to every kind of situation, as the authorities strongly discourage the implementation of one-size-fits-all approach.[373] However, rules should be made clearer and the attitude towards compliance, and more importantly, towards the execution of compliance measures, requires a higher level of consistency across countries and sectors. Otherwise, how much can be achieved in terms of due diligence, when in one country checks can be easily performed, while in other countries you stumble over the lack of accessible records and strong traditions in preserving secrecy?

Another important question is – what happens when something does not appear to be risky (or is under the risk-threshold) but, in the end, results in far more serious implications than initially expected? Besides, it should be taken into account that in applying a risk-based approach there exists a 'reverse risk', *i.e.* the risk of being wrong, or in statistical terms, the possibility of false positive and false negative errors (Gelemerova, 2008). This issue can be addressed only within a system of adequate feedback from regulators and law enforcement agenicies which enables reporting institutions to validate risk-characteristics. However, state agencies fail to provide adequate feedback and this defect appears to be a global one (see Van Duyne, 2007a; Verhage, 2010).

It is not clear what the implications would be if a PEP or another risk factor slips through the system and whether banks should be held accountable.[374] In addition, real professional launderers will attempt to manipulate their risk profile (or the risk profiles of their clients) downwards (as they do already today). In simple terms: who wants to be or look like a PEP?

Although it may be difficult to prove in a criminal context that a banker had doubts about a transaction but decided to ignore it (Levi, 1993), law enforcement authorities and regulators can probably always find a reason for a sanction. Sanctions, however, do not necessarily result in better quality intelligence (Gelemerova, 2007) but can lead to over-compliance (see Harvey, 2005) in the

373 For instance, in January 2009 the UK Financial Services Authority (FSA) fined Aon Limited, a UK insurance broker, for having a one-size-fits-all approach and thus "*failing to take reasonable care to establish and maintain effective systems and controls to counter the risks of bribery and corruption associated with making payments to overseas firms and individuals*" (FSA, 2009, retrieved online and therefore no page number is available; see also FSA, 2009a). Although this concerned the company's anti-corruption compliance system, such measures are closely intertwined with anti-money laundering compliance, especially within the regulated sector of reporting institutions (see section 4.4.3.).

374 The JMLSG handbook, mentioned earlier, notes that the FSA is unlikely to take enforcement action if a firm demonstrates that it has put in place an effective system of controls. But what essentially 'an effective system' means is unclear. The guide and other available guidance typically use broad terms such as 'reasonable care', 'reasonable steps', 'appropriate steps', 'appropriate procedures' *etc.*, which fall short of explicitly defining the minimum prescribed standard that would guarantee defence against enforcement action (Gelemerova, 2008).

form of over-reporting. Additionally, despite the fact that reporting institutions are given the opportunity to make their own risk assessment and on that basis to decide on the scope of due diligence, there are situations which require enhanced due diligence in any event. For instance, even if reporting institutions regard a situation as 'low-risk', it appears that, according to the Third Directive, correspondent banking relationships with respondent institutions from third world countries as well as non-domestic PEPs and their sources of wealth in any event should be subject to enhanced due diligence.

Ultimately what is important to remember within the remits of the risk-based approach is that reporting institutions should know who it is they are dealing with, *i.e.* the know-your-customer rule about establishing the customer's identity, nature of business, place of employment, sources of funds, and so on (Gelemerova, 2008). On that basis, reporting institutions have to determine the level of risk, and, depending on the level of risk, decide on the scope of due diligence. Clearer criteria would certainly make things easier. Ambiguous and ill-defined terminology as well as the lack of systematic feedback from the authorities and FIUs[375] to the reporting institutions are among the major setbacks in financial intelligence gathering. It is obvious that, in the absence of clearer criteria, risk assessment and risk-based decision-making can be a risky undertaking in itself as it largely depends on the intuition, common sense and conscientiousness of individual staff members (Gelemerova, 2008). At an AML event in New York in 2007, financial services executives expressed a concern that the risk-based approach, with prosecutors acting as supervisors, was being used to actually raise the compliance standards rather than make things easier (see Davis, 2007). Compliance officers may now have to take into account, not so much their own judgement of AML risks, but rather the latest regulatory sanctions and enforcement actions (see Davis, 2007). When in the absence of clear standards it is the regulatory risk, rather than actual AML risk, that drives institutions to report, the danger is that the risk-based approach may in turn slide back to over-compliance (see Harvey, 2005). In the end, the real risk to the banks is the combination of regulators and sanction-related reputation damage. And in that order, we should stress again: money-launderers do not take money *out* of the bank, they bring it *into* it. So we cannot expect money laun-

375 The usual excuse is that the authorities cannot provide feedback on specific cases because this can compromise investigations (if any). However, reporting institutions/persons do not necessarily expect feedback to mention specific individuals or companies but to provide generic guidance and assurances that reporting officers understand the rules. More detailed feedback in terms of general statistics can also be helpful.

dering risks to decrease any time soon. On the contrary, as it appears, banks and other regulated institutions will be facing an increasing need to conduct due diligence checks.

4.4.3. The global financial Panopticon

Intelligence gathering tools ancillary to AML/KYC rules

Earlier in this thesis we asked ourselves whether the global Panopticon is the much desired panacea against crime for profit. The anti-money laundering regime with its KYC system and obligation to report suspicious activities appears to be turning, indeed, into some form of a global Panopticon. Although the reporting obligation applies only to the regulated sector (*i.e.* banks and other financial services institutions among others), the aiding and abetting offences, particularly in combination with the range of other ancillary compliance issues arising from the US Foreign Corrupt Practices Act (FCPA), sanction lists,[376] non-proliferation (of weapons of mass destruction)[377] and anti-terrorism regulations, especially in a penal-law globalised environment, can make virtually everyone accountable. For instance, let us imagine that, in a hypothetical scenario, a UK steel trader A sells steel produced by a Russian steel maker B. B is controlled by a controversial businessman C. The steel is sold to a German car-maker D and a US aircraft manufacturer E. D has just been bailed out by the German government and so it is partly government-owned. A uses agents to sell the steel. You may think that none of this has anything to do with

376 A range of national and supra-national bodies and organisations, such as the US OFAC, administer and enforce sanctions and restrictions. For instance, the US OFAC, Office of Foreign Assets Control of the US Department of the Treasury, administers and enforces economic and trade sanctions designed to protect US foreign policy and national security interests and targeted against certain jurisdictions, regimes, terrorists, narcotics traffickers, those engaged in the proliferation of weapons of mass destruction, and other threats to the US national security, foreign policy or economy (for further details see US Department of the Treasury's website at: http://www.ustreas.gov/offices/enforcement/ofac/).

377 In addition to the range of trade sanctions and restrictions there are also regula-tions relating to the export of dual-use items and technology aimed at ensuring the disarmament and non-proliferation of weapons of mass destruction. Fuhrmann (2006) notes that proliferators use front companies, intermediaries and often forgery in order to circumvent export controls. Therefore banks and other financial institutions have to seek to ensure that they do not facilitate proliferators. As a result, the concept of 'suspicious transaction' expands to include also transfers that relate to the export of dual-use substances (*e.g.* such that can be used both for the production of fertilisers and the making of explosives). Fuhrmann (2006) highlights that the authorities must go beyond merely informing the private sector about export control. In cooperation with the private sector, they must develop an agreed set of international best practices, standardised compliance programmes and a channel for communication to share intelligence relating to end-users of proliferation concern. It is important to devise strategies of engagement driven by incentives, rather than by punishment (Fuhrmann, 2006).

money laundering, let alone with reporting any suspicious activity to financial intelligence units. However, any marginal irregularity in the trade finance documentation submitted by A's agent in the US to its servicing bank in the US can trigger the suspicion of a vigilant bank officer. A commonly considered red-flag such as a risky product or a risky jurisdiction, or a PEP link can also trigger suspicion.

Let us imagine that in the described case, a bank officer discovers that C, the owner of the Russian steel maker (whose products are being sold by the agent), is deemed as a PEP (for reasons subjective and not quite clear to the banker). He decides that this warrants further scrutiny. As a result, he discovers that the agent's documents contain contact details of an office in Iran, although it is not quite clear why. However, being aware of the US sanctions against Iran and the AML/anti-terrorism legislation, the banker decides that the transaction is suspicious and the matter should be reported to FinCEN. In the end, the tip-off to FinCEN, (which originated as a simple know-your-customer check), triggers an investigation into all parties involved which goes beyond the remit of anti-money laundering regulations. As it turned out, the agent in the US had issued inflated invoices to the US aircraft manufacturer. This could have been pure fraud but may have also been related to offences with which we associate a far more sinister 'threat imagery', *i.e.* the gain from the deception may have been a drop in the ocean of terrorist funding.

Due diligence may be an explicit obligation for the regulated sector only, but the lack of awareness and of an explicit obligation for those outside that sector does not appear to provide defence in cases where companies fail to comply with the range of rules and prohibitions other than anti-money laundering regulations, such as anti-bribery, counter terrorism, non-proliferation and other sanctions and restrictions, that are closely intertwined with KYC rules and AML regulations.[378] Thus, if the US aircraft manufacturer E is not prosecuted as an accomplice in money laundering, it may be fined by the US authorities for failing to keep efficient compliance and control systems and preventing potential terrorist financiers from raising and laundering funds.[379] The UK trader A may be fined for similar reasons in the UK. Moreover, if it turns out that A's agent in Germany has greased the palms of a senior manager

378 For those within the regulated sector the US authorities have even issued a manual of which a section is aimed to help companies check how they manage 'OFAC risk' compared to Bank Secrecy Act expectatations (FFIEC, BSA/AML Examination Manual, July 2006).

379 The US Counter Terrorism Sanctions apply to all US persons and entities (companies, non-profit groups, government agencies and so on) wherever located.

of the German car-maker in order to ensure the purchase of the steel, then A may be prosecuted under the US Foreign Corrupt Practices Act ('FCPA')[380] and may be sanctioned in the UK for failing to take reasonable care to establish and maintain effective systems to counter the risks of bribery and corruption of overseas firms and individuals (see Aon Limited case, FSA, 2009 and 2009a).[381] Additionally, disguising the funds allocated for the bribe can be qualified as laundering, which brings us back to the anti-money laundering regulations.

The FCPA, especially when coupled with anti-money laundering regulations, has become a powerful tool to keep businesses with international exposure on their toes (see Gelemerova, 2010). Similarly to drug trafficking and anti-money laundering policies (as described earlier in this thesis), the US has also been the driving force behind legislative developments in the area of corruption of foreign officials. As was the case with AML developments, awareness of the phenomenon was first raised during the Watergate scandal when it became known that a considerable number of US companies maintained 'slush funds' and were engaged in systematic bribery of foreign officials and political parties to gain business. These corrupt payments were concealed from audit and public scrutiny (see SEC Report, 1976; Thomsen, 2008). Large-scale corruption is a complex matter which is often connected to a range of other, not less complex crimes, such as fraud and money laundering, for 'tautological reasons', particularly given the broad definition. Not only may it require laundering in the narrow and broad sense of the term, but laundering may be inherent: inbuilt by tautology. The nature of the relationship between the corporation and the government official is concealed, as is the concealment of the promise, offering and receiving of the advantage and the subsequent reward. The corruptly gained advantage is illegal (*e.g.* the contracts that Siemens was alleged by US prosecutors to have obtained through bribery were 'proceeds' too, and the manner in which they originated was concealed). The subsequent reward constitutes an 'illegal advantage' too; both, the corruptly gained advantage and the reward, qualify as 'proceeds', the handling or concealing of which, is laundering under the broad definition of international regulations (see Gelemerova, 2010).

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380 Perhaps a much more likely scenario, one might think, would be to have goods sold to a Nigerian government-controlled firm, as the level of perceived corruption in Nigeria is much higher. However, cases of FCPA prosecution in the past ten years or more clearly indicate that individuals in developed countries are not too reticent either when it comes to engaging in corrupt practices (see Gelemerova, 2010).

381 As a result of the bail-out of the German car-maker, *i.e.* the government taking control over it, its executives can be considered government officials as interpreted by the US authorities in the context of the US Foreign Corrupt Practices Act (see Gelemerova, 2010).

The scale of malpractice unearthed in the aftermath of the Watergate scandal required action. So it was decided that criminalisation would be the most effective deterrent (see Staggers, 1977). Thus, in 1977, the FCPA, the first major US law that addressed bribery of foreign officials, was adopted. However, it was important to ensure that other countries introduced similar legislation to level the playing field so that non-US firms did not have a competitive advantage over US firms (Gelemerova, 2010). In 1997 US lobbying efforts finally led to the adoption of the Organization for Economic Cooperation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the 'OECD Convention'), which, in fact, in some respects was even more rigid than the FCPA. Thirty-three countries committed to complying with it and making the bribery of foreign officials a criminal offence (see for more details Gelemerova, 2010). The US had to adjust the FCPA to the more rigid requirements of the OECD Convention and thus, in 1998 the US Congress introduced the International Anti-Bribery Act, which essentially expanded the FCPA's scope and reach.[382]

In addition to its anti-bribery provisions[383] the FCPA also contains important accounting provisions which require US security issuers[384] to maintain

382 Firstly, the FCPA now included payments made to secure *any improper advantage*, in addition to criminalising payments made to influence a decision of a foreign official or to induce him to do or omit to do any act. Secondly, public officials now included also officials of public international organisations. Thirdly, in addition to *domestic concerns* and issuers under the 1934 Securities Exchange Act, the scope was expanded to apply to all foreign persons who commit an act in furtherance of a foreign bribe while in the US. Fourthly, it was expanded to assert jurisdiction over US businesses and nationals for acts in furtherance of unlawful payments outside the US. Fifthly, the amendmends eliminated the disparity in penalties applicable to US nationals and foreign nationals employed by, or acting as, agents of US companies (previously, foreign nationals were subject only to civil penalties) (see Gelemerova, 2010, where the subject is discussed in detail).

383 In summary, FCPA's anti-bribery provisions prohibit any person, while in the territory of the USA, US issuers and domestic concerns, their subsidiaries, officers, directors, employees, agents and stockholders, from making use of any means corruptly in furtherance of giving anything of value to a foreign official in order to obtain or retain business, or secure any improper advantage. The term *corruptly* indicates an intent to wrongfully influence the recipient which means that the act of bribery does not have to have taken place or have produced results for the FCPA to be enforced. Furthermore, although the FCPA provides an exemption for facilitating or grease payments (*i.e.* such that are made to expedite a *routine governmental action*), a number of legal cases indicate that that there is scope for interpretation. For instance, in United States v. Kay, 2004, it was confirmed that the law also applies to undue advantage in the form of favourable tax or customs treatment. It essentially means that any questionable payment made to obtain an undue advantage over industry rivals and/or increase profits, including through favourable tax or customs treatment, can fall within the scope of the FCPA (for further analysis see Gelemerova, 2010).

384 'Issuers' are companies issuing and selling securities on the stock-exchange. Under the FPCA, issuers are US or foreign entities which have a class of securities registered pursuant to the US Securities Exchange Act of 1934 or which are required to file reports under the same Act.

internal accounting controls and keep accurate records of all transactions. These provisions place the FCPA in particularly close proximity to AML regulations, as any company which seeks to conceal an illicit payment in the context of the FCPA (*e.g.* a bribe or expenses for entertainment of a government official, and so on), for instance, by using false accounts or false contracts, can become the subject both of FCPA prosecution and a money laundering investigation (Gelemerova, 2010).

Indeed, FCPA's language, similar to that of the anti-laundering law, was cast in terms designed to avoid any loopholes and expand FCPA's reach as far as possible. Of particular relevance is the fact that the law enables the US authorities to assert territorial jurisdiction over any foreign person when there is some connection to the territory of the US or use of the interstate or foreign commerce of the US. For the territorial principle to apply it suffices, for instance, to have an office or a representative in the US, make payments through a US bank or send emails via a US server. The global reach of the FCPA (and its aggressive enforcement by the Department of Justice and the Securities and Exchange Commission, see Gelemerova, 2010), especially in combination with similar legislation introduced outside the US,[385] now means that companies with international operations and some connection to the territory of the US have to ensure that they apply due diligence as a major element of their anti-corruption efforts (for comments from industry experts see McCann, 2009). But unlike anti-money laundering due diligence which is an explicit obligation for the regulated sector, anti-corruption due diligence does not appear to have been explicitly prescribed. Yet the numerous cases of FCPA prosecution, including the cases of the German Siemens and the Norwegian Statoil, indicate that those companies which fail to maintain efficient controls and prevention systems face the risk of sanctions. Key to efficient control and prevention is, indeed, due diligence, especially in avoiding successor and agent liability. Not only does it discourage corrupt conduct, but it also provides opportunities for self-reporting in order to avoid prosecution and mitigate any possible punishment (see Gelemerova, 2010). Thus, the self-reporting (or voluntary disclosure procedures) fit perfectly well into the intelligence gathering mechanism operated by the authorities.

385 The UK Bribery Act of 2010 (expected to come into force in 2011) is even stricter than the FCPA in some respects, including with regard to facilitation payments.

Cracks in the Panopticon?

Those within the regulated sector (*i.e.* the reporting institutions under AML regulations) at least know they have to conduct the basic know-your-customer checks, although the risk-based approach seems to be putting the benchmark higher and higher. For those outside the regulated sector, due diligence is not an explicit obligation. But they are becoming increasingly aware of the complex nature of the range of compliance risks, including those arising from the FCPA/OECD Convention and other anti-bribery legislation, trade sanctions, non-proliferation controls and other restrictions, and so they too inevitably become part of the global Panopticon. So far, so good. Only it is not clear, with so much law enforcement and regulatory aggression, how much can be achieved when there is a web of interconnected compliance issues, restrictions and obligations, yet significant uncertainty with regard to compliance standards and the practical implementation of rules and procedures. This often means that due diligence is either absent or is simply turned into a simplified 'tick the box' exercise, especially in a situation of economic downturn when it is a matter of priority for businesses to cut back on costs (Gelemerova, 2010). Furthermore, it may be an increasingly globalised penal-law environment but it is still a considerably fragmented environment when it comes to putting compliance (anti-money laundering, anti-corruption and so on) measures into practice. Standards, attitudes, corporate cultures, availability of public sources of information, privacy and data protection laws, due diligence and legal practices vary from country to country (see Gelemerova, 2010). Even within one specific banking organisation with long traditions in due diligence and compliance, what is preached at headquarters, is not necessarily practiced company-wide.

Surely all this must impact on the efficiency of the global Panopticon. Indeed, as we can see, there is no evidence that money laundering activities have diminished or will diminish any time soon. So how effective then is the global AML regime, also in relation to the FCPA? Notably, a number of high-profile FCPA investigations have uncovered that alleged bribery payments of considerable amounts had been made by reputable firms, over relatively long periods of time, often involving false contracts as well as accounts and/or firms registered in tax haven jurisdictions (see Gelemerova, 2010). In those cases all signs of money laundering (as broadly understood under the international regulations) were present but, for some reason, apparently remained unnoticed for some considerable time.[386] The same applies to the range of elite crime cases that shook the industry in the early years of this decade, *e.g.* Enron and WorldCom, followed by the Madoff and Stanford cases in 2009. Are we not seeing big cracks in the global Panopticon?

These observations underline the fact that the fight against money laundering is based on a rhetoric political superstructure with dire consequences in the compliance orbit but little or no evidence of success. The entire business, globally, is called upon to conduct due diligence and gather information to ensure that profit-oriented crime does not pay, but thus far little has been done by the authorities to ease and streamline the process of information gathering[387] or to design some performance measurement procedure.

Moreover, we usually hear about compliance when it comes to 'threat imagery' mainly related to the 'usual suspects', *e.g.* drug trafficking, but at present also terrorism, nuclear-weapons proliferation financing and other similar hazards that have a highly political connotation. We have also started hearing about the hazards of corruption of foreign officials. For some reason, however, little is done to raise awareness of laundering activities relating to domestic corruption, environmental crime, elite crime and other inconvenient topics. In addition, we hear much about laundering involving real estate transactions while finding so little empirical substantiation (Van Duyne *et al.*, 2009). At the same time we hear little of suspicious trade in artwork, although whitewashing illegal archeological finds by false documents of provenance is a laundering act in the strict sense of the term. Similarly, the auctioning and re-auctioning of stolen art is a method by which a white-wash effect can be achieved (Charney, 2009).

Irrespective of how many dodgy offshore banks and offshore companies through which crime money has gone, at the place of investment the origin of this money can still be questioned. The advantages which globalisation offers to money launderers are not necessarily the perfect laundering solution. Domestic laundering, for instance, through real estate fraud, investment in artwork or corruptly gaining public procurement contracts can sometimes be much easier.

386 Even if any of these anti-corruption investigations has been triggered by a tip-off to a financial intelligence unit, it remains a question as to how soon this tip-off was made after the start of the corrupt activities.

387 While the FIUs are responsible for gathering information relating to laundering and terrorist financing, other bodies may be designated for collecting reports on suspected breach of trade sanctions, foreign bribery and non-profileration legislation and other restrictions, despite all this being suspected crime predicate to money laundering. It appears that there is a need of streamlining the reporting and intelligence gathering process.

As noted previously, while the international banking industry has been under intense scrutiny for a number of years, the extent of scrutiny over other sectors, including real estate agents, art dealers and auction houses, or government officials involved in public procurement, remains a question. In terms of financial scale, money that can be circulated and gained through real estate or artwork indeed can reach excessive amounts. According to Bulgarian prosecutor Plamen Panayotov, the fraudulent trade in properties can be much more profitable [and safer] than illegal drug trafficking or prostitution.[388] But fraud and elite crime do not have the threat image of drug trafficking, as we have seen.

388 *Banker Weekly*, 26 September 2009.

5. Panopticon built on quicksand. Concluding Remarks

5.1. Fighting laundering: the sacrifices on behalf of a vague virtue?

The purpose of this thesis was to examine the applicability and adequacy of the legal term 'money laundering' in the context of globalisation, particularly the globalisation of money laundering and of the fight against it. If the purpose of designing the anti-money laundering system has been to curb economic crime and the related money laundering, has the anti-money laundering system been built on solid grounds, *i.e.* on clear definitional basis, or is rather built on a constantly shifing platform similar to a Panopticon built on quicksand?

As we have seen, the language of anti-money laundering policies contains much vagueness. The set of copied definitions reviewed in this thesis does not touch the essence of money laundering: to provide a justification for the ownership of the proceeds. As far as the 'financial life' of the criminal is concerned, he wants to spend his ill-gotten profits worry free and this implies: removing the traces of the predicate crime and avoiding nasty questions about one's wealth. The most effective 'laundering method' is: do not draw the attention of the law. Policy makers have expanded this to include any handling of crime money, including keeping it under your mattress. For good reasons one can criticise this as not being laundering in the strict sense of the term. However, the legislators have given it that name and the world accepted that. Is this global 'etikettenschwindel'[389]? Yes, and that is what most money laundering legislation appears to be all about. But the legislators and law enforcement agencies can happily live with that.

This vague and all-encompassing language chosen by policy makers urges sacrifices from the financial sector (and other industries, as discussed in the previous section) in terms of material efforts: training courses, extra staff or a separate compliance department. Such cost is always viewed by companies as significant, no matter how small it is compared to the investment companies are prepared to make in market research or advertisement, for instance. Market

389 This usually means that different labels are given to the same content. Here we have a reverse 'etikettenschwindel': the label of laundering remains the same but given the ambiguity of the meaning of laundering, its content is changed to accommodate to changed political requirements.

research can generate business, whereas compliance is largely viewed merely as a cost-generating unit.[390] Such are the commercial realities.

For small and medium-sized companies it is significantly more difficult. While it cannot be expected from smaller companies to have separate departments dealing with compliance issues, the required extra alertness is nevertheless a burden. Businesses are in a state of continuing uncertainty whether risks have been correctly assessed lest they may be browbeaten by the supervisors. Consequently, from a management perspective, the main risks appear to come from the regulatory supervisors, not from the launderers. This means that companies inevitably build up their compliance attitude and efforts towards warding off attention from regulators rather than avoiding the broader corporate risk which includes being defrauded by unscrupulous partners or employees (Gelemerova, 2010).

Furthermore, sacrifices have been made in terms of safeguards for preserving confidentiality on matters relating to clients. This has become a particularly sensitive matter for a number of groups of professionals, such as lawyers (as discussed previously), accountants and notaries, who have become part of the AML-regulated sector. As we have seen, significant uncertainty has been created, for instance, with regard to lawyers who now have to think twice before accepting to work for individuals suspected of involvement in crime for profit. But, after all, who is beyond suspicion? If all this is unambiguously for the 'general good', these sacrifices could be considered justified. But how certain is this without performance measures? Disclosing confidential information to the authorities in order to assist them in tackling 'serious' crime and ensuring that everyone abides by the law is a good cause indeed. In an ideal world (although in an ideal world there would be no crime), the state administration and those responsible for the fight against crime would be incorruptible. But we do not live in a perfect world and the system is open to abuse. Performance accountability is lacking or insufficient, while there is no indication that crime for profit is declining. The level of availability of illegal drugs has remained, more or less, the same or has increased while prices have decreased; financial and economic crime – the main criminal earning facility – is still relatively low on the policy makers' agenda or, at best, has gone up on the agenda slightly, but given the enforcement history, probably only temporarily. Despite law enforcement's broad powers, estimates provided by national and international authorities sug-

[390] Compliance and fraud prevention officers can actually save cost that is arising from regulatory and law enforcement sanctions and the more general corporate risk of being defrauded, for instance.

gest ever increasing volumes of money laundering. One may wonder why. Is the problem really that significant or does the reported size of the problem reflects the authorities' tendency to indulge in the 'big figure game', increasing their importance as well as justifying their claim for tougher law enforcement measures and bigger budgets?

In addition to the material sacrifices there is the eroding of the law because of the self-laundering ramification and the lack of precision which is characteristic for the entire AML system. The ambiguity of definitions leads to arbitrary results and uncertainties in the application of penal law, which is particularly problematic in the context of globalisation when law enforcement and regulatory efforts should be standardised globally to fight crime that is claimed to be globally spread. But standardisation requires precision of conceptual definition. How far should we go with the criminalisation of the various financial aspects of a criminal's conduct? Should any use of crime-money be qualified as money laundering, even where the criminal is involved in licit transactions following the predicate crime? It seems that anything can be construed as a form of use of crime property and an intent to launder. US law envisages also the very broad intent to *promote the carrying on of specified unlawful activity* as a possible laundering prerequisite. Not all countries have verbatim introduced into their legal systems the broad money laundering definition advocated by the USA. As noted earlier, Austria has not criminalised self-laundering. But countries which deviate from the broad definition that is so religiously fostered by the USA risk to be criticised for uncooperative attitude, extradition and forfeiture regime gaps. Of course, the authorities should seek to ensure that crime does not pay and that justice is done, but that has to be done through mechanisms that do not erode the legal certainty, *lex certis*, principle, the legal safeguards of justice. It appears that the broad money laundering definition has allowed prosecutors to erode the basic principle of law, *lex certis*, without even having to make a *prima facie* case. And all this started in the name of combating drug trafficking accompanied by a lot of 'threat imagery'. But was it really the drug menace only? As we have seen in previous sections, there is a valid reason to believe that, in fact, tax evasion prompted this sacrifice. But the drug issue was apparently a convenient political crowbar to open the door to the taxman. What is it then that policy makers are aiming for? If we fight money laundering as a way of fighting the underlying crimes, hoping this will decrease drug trafficking and tax evasion, it is time to reflect on a less costly and better defined and structured instrument with a less eroding effect on our legal system.

Applying the AML strategy, as it stands now, as a general tool to fight crime is of little help because each type of criminal offence may require different complementing measures to reduce its prevalence. For instance, drugs form a social and public health problem and there may be better solutions in this direction[391] that could help curb the illegal trade and *ipso facto* reduce laundering. A stricter fiscal control policy with the application of a net-worth analysis would likewise reduce laundering opportunities. Looking for alternatives and intensified application of existing legal provisions should be seriously considered instead of plugging the money laundering clause in every legal loophole.

That said, there is nothing wrong with being able to use the money laundering charge, where everything else fails, in order to ensure that crime does not pay. However, this has to be balanced against putting at risk the main principles of law. For instance, if no predicate crimes are proven to the criminal standard of proof, why would the authorities not follow the civil recovery path instead of applying criminal procedures? Especially in cases of tax law violations and corruption offences, essentially crimes committed by the business and political elite, where proceedings get protracted for many years at the expense of the ordinary tax payer. In the end defendants are acquitted or escape with lenient punishment, their assets remaining largely intact. If Mr Big was unable to prove a legitimate source for his income (which could have been firmly established through a net-worth analysis), then this could have simply meant that he had failed to declare all his sources of income, which in turn could have meant classic tax evasion. He could be convicted of tax evasion and false accounting which again can be a cross-over into the criminal law world but without necesserily having to call that money laundering. Surely prosecuting for tax evasion is effective enough without having to blurr the lines by calling tax evasion money laundering. However, as previously noted, it appears that for law enforcement authorities and prosecutors, pursuing a laundering conviction is far more admirable than proving tax evasion and/or using civil recovery procedures.

It appears that the fight against money laundering has become a variable of political choices and subject to double standards rather than a targeted effort to curb crime for profit. The 'threat imagery' and the self-laundering charges are

[391] There may be means, more effective than prohibition and warfare, to fight the abuse of drugs. Regulating the cannabis market and the medical provision of a maintenance dose (for instance, based on the experience in Switzerland and the Netherlands) could be considered as measures that address both the supply and the demand side (currently the focus is on the supply side, as discussed earlier).

conveniently used to ease the fight against the laundering of drug trafficking proceeds, human trafficking and other crimes attributed to the 'usual offenders'. Meanwhile the low level of priority of the fight against elite crime is becoming inconveniently glaring. History has shown that it is not easy to keep such offences high on the political agenda (Van Duyne, *et al.,* 2003a). We find a similar differentiation when it comes to 'non-cooperative' countries: here we have 'usual suspect' countries too, which are more likely to be labelled as such than any of the industrialised countries where most of the crime money finally ends up.

5.2. Gathering intelligence or randomly wasting resources

It seems that somehow, despite its overarching design, the AML regime is not utilised in the most efficient way. It appears to primarily focus on the banking and money transmission businesses. If this is because it is the best way to gather intelligence on crime money management and logistics structures (as this is where dirty money is most likely to resurface from the underworld) and gain leads to predicate crimes, then we should not merely '*fight*' money laundering – rather, we should *watch* it and follow the money trail. If the design of the entire reporting system was aimed at gathering intelligence, then why not to make rules clearer and start referring to things as they are? It is one thing to criminalise any crime-money management, labelling it as laundering, without distinguishing between the predicate offender and the professional launderer thus affecting the basic principle of law, *lex certis*; it is quite another to criminalise laundering in the narrow sense but leave the obligation to report any suspicious activity. It appears that by jeopardising the *lex certis* in order to achieve political convenience, we have replaced one hazard with another: in order to curb money laundering policy makers have undermined the basic safeguards of law.

The system, as it stands now, certainly needs a higher level of clarity. FIUs have to receive more feedback from the regulatory and law enforcement agencies they provide intelligence to. In turn FIUs have to provide feedback to the reporting institutions, which rarely happens. The flow of information is usually one-way, although FIUs and regulators also need to be accountable, including for omissions and failures.[392] FIUs and other law enforcement agencies have to put in place mechanisms for regular and methodical feedback to reporting institutions. Money laundering is after all not so much a threat to society but rather

[392] As noted in Gelemerova, 2008.

the 'Achilles Heel' of criminal activity by which offenders can be identified (Gelemerova, 2008). Similarly to a radar system, it sends pulses that help regulatory and law enforcement bodies to spot criminals. Through intelligence provided in suspicious transaction reports, FIUs can identify leads to predicate crimes. However, this can only be ensured by a system that is well designed and equipped to spot such transactions. Reporting institutions cannot be left entirely to their own devices, as they are largely profit-oriented and cannot be expected to act as unpaid detectives (Gelemerova, 2008). Indeed, policy makers started their anti-money laundering war by setting up some prescriptive rules and standards, and then, for better or for worse, introduced the risk-based approach. As a result, at present there are some minimal prescribed standards as to what elements risk assessment and compliance systems should contain (*e.g.* due diligence checks, a whistleblower hotline, strict record keeping and entertainment policy), but there is significant inconsistency as to the actual implementation of what companies have on paper (see Gelemerova, 2008, and Gelemerova, 2010). As the existing minimal standards are insufficiently clear and inconsistently applied, the result is a simplified and, often, mindless exercise of ticking boxes with unclear contents. The risk-based approach has certainly its benefits but it has to rest on unambiguous principles and clear minimal standards. Therefore, despite the introduction of the risk-based approach, further clarity in rules is imperative. The need for clarity is pressing because anti-money laundering policies, with their imbedded obligation to report suspicious transactions and all the ancillary anti-corruption, non-proliferation and anti-terrorist financing laws, sanctions and other retrictions, is turning into a normative set of rules nonetheless.

More attention has to be paid to the practical side of achieving a balance between the profit-oriented nature of the reporting institutions, their fear of regulatory and law enforcement sanctions and the need to ensure a reasonable level of transparency of business. Reporting institutions would certainly benefit from having basic prescribed standards and automated knowledge-based systems, or artificial intelligence networks (Gold and Levi, 1994) in an effort to minimise the margin of subjective assessment and establish an optimal suspicion threshold (Gelemerova, 2008). Most importantly, if money laundering as a global phenomenon has to be tackled on a global scope, it is necessary to ensure that not only general legislative framework but also relevant guidance, standards and criteria, as well as implementation are consistent across countries. The FATF has sought to achieve some level of consistency in the anti-money laundering approach across the world. However, it remains a question whether all specific measures it has recommended have indeed worked, even if they have been seriously adopted. After all, it is still crime business –as-usual. Further effort in achieving clarity and consistency is needed. Otherwise there is a chance that crime for profit and money laundering will continue to flourish due to, *inter alia*, cross-border opportunities arising from regulatory and law enforcement inconsistencies across countries (as previously discussed, 'criminogenic asymmetries', see Passas, 2002). However, that should not stand in the way of context determined compliance, lest the authorities start thinking again in terms of a universal 'golden bullet'.

5.3. Measuring the money laundering phenomenon

As reviewed in this thesis, any meaningful analysis of the money laundering phenomenon proves to be quite a difficult exercise. The legal construction of money laundering is so broad that even in a penal-law globalised environment, what we see as money laundering, here and there, is like a patchwork of tax evasion and hidden economy, a little bit of money under the mattress, quite a lot of money sitting in a bank account offshore, and probably even some invested in reputable businesses but not so much by drug traffickers, rather by elite crime high-flyers. The definition, as it stands now, does not allow recognising differences in financial conduct and intentions, and nuances in crime money colour. From the literature on laundering one cannot deduce whether such a differentiation was ever intended; rather we have observed an indiscriminate extending of the frontline wherever there was a political opportunity to do so.

Building up the AML regime on the basis of such a loosely and ill-constructed money laundering definition is equal to building a Panopticon on quicksand. The lack of clarity only leads to more sacrifices without any guarantee of observable results in our social and economic life. Academic research, that is so necessary for the efficient functioning of legislative, law enforcement and regulatory bodies, will have to take into account the lack of clarity with regards to the money laundering definition and all related AML compliance issues. Particularly, an account should be taken of the confusion arising from the inconsistent and interchangeable application of the narrow and broad menings of money laundering.

While the fight against such a broad phenomenon appears to involve much political rhetoric, the tools used by the authorities to 'fight' this broad phenomenon can actually be of much more help but are not used wisely. In the end, the system bites but, as it appears, it primarily bites the small fry and the unaware.

5.4. The global Panopticon – concluding remarks

As we have seen, although crime for profit has existed since at least the time of King Hammurabi, the money laundering phenomenon started to receive immediate urgency during the 1970s when the US authorities introduced the Bank Secrecy Act. It was expected that the BSA could be used as an intelligence tool to control the flows of money (leaving the US), thus intended to create some form of a global Panopticon. However, after this failed to achieve the desired results, during the 1980s it was decided to make the movement of tainted money a separate criminal offence, allegedly to control drug money. However, as this did not suffice either, the US authorities took the drive outside the USA imposing its anti-money laundering standards globally, largely through the FATF, founded in 1989. Through peer pressure, the FATF succeeded in imposing its recommendations mainly on developing countries and jurisdictions traditionally known as tax havens. Financial intelligence units were set up in nearly every country to collect information on suspicious transactions from a range of reporting institutions. National and international anti-money laundering legislation, including the EU Directives, has thus become indeed a global financial control instrument – a Panopticon. However, has money laundering been curbed? In the end, we have almost forgotten why we started all this. It is almost as if it is not the laundering that counts, but the possibility to exert control and to empower the prosecution. Yet this extended system of control does not appear to be working. Rather, given the lack of performance measures, we do not know how it is working: even concerning unintended effects we learn anecdotally. Its definitional basis, as we have seen, is unclear resulting in uncertainties and inadequacies in the application of penal law and regulations. Left to their own devices, reporting institutions struggle to understand whether their compliance procedures are adequate and often resort to a simplified 'tick-the box' exercise in due diligence. Should they be blamed for that? After all, the most primary threat to them is not the launderer bringing money *to* the bank, but the browbeating regulator who may take money *out* of the bank by fining them. Such a simplified risk avoidance approach takes us nowhere, because what matters is responsibility, and that goes beyond tick-the-box compliance. But there are limits to what corporate responsibility can do on its own (see Vogel, 2005; Caulkin, 2006) in the absence of explicit rules and clearer regulations. Moreover, if the money laundering phenomenon is of a global scope, regulatory and law enforcement efforts should be consistent across countries. While the penal law approach has been accepted almost universally, the practical implementation of due diligence and reporting practices has remained inconsistent across businesses, sectors and countries, largely due to ill-defined terms, unclear rules and varying legal and corporate cultures. It is indeed a Panopticon built on quicksand. However, despite the obvious lack of clarity impeding the efficient functioning of the global Panopticon, the authorities continue to pursue their warfare unabated and further tighten their control. One may wonder what is more threatening: the age-old laundering phenomenon or the control hunger of the authoriries, learning so little of their own Panopticon.

6. Addendum

US Money Laundering Control Act of 1986 (amended)

TITLE 18 > PART I > CHAPTER 95
§ 1956. Laundering of monetary instruments

(a)
(1) Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity—
(A)
(i) with the intent to promote the carrying on of specified unlawful activity; or
(ii) with intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code of 1986; or
(B) knowing that the transaction is designed in whole or in part—
(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or
(ii) to avoid a transaction reporting requirement under State or Federal law,
shall be sentenced to a fine of not more than $500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both. For purposes of this paragraph, a financial transaction shall be considered to be one involving the proceeds of specified unlawful activity if it is part of a set of parallel or dependent transactions, any one of which involves the proceeds of specified unlawful activity, and all of which are part of a single plan or arrangement.
(2) Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the United States to or through a place outside the United States or to a place in the United States from or through a place outside the United States—
(A) with the intent to promote the carrying on of specified unlawful activity; or
(B) knowing that the monetary instrument or funds involved in the transportation, transmission, or transfer represent the proceeds of some form of unlawful activity and knowing that such transportation, transmission, or transfer is designed in whole or in part—
(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or
(ii) to avoid a transaction reporting requirement under State or Federal law,
shall be sentenced to a fine of not more than $500,000 or twice the value of the monetary instrument or funds involved in the transportation, transmission, or transfer, whichever is greater, or imprisonment for not more than twenty years, or both. For the purpose of the offense described in subparagraph (B), the defendant's knowledge may be established by proof that a law enforcement officer represented the matter specified in subparagraph (B) as true, and the defendant's subsequent statements or actions indicate that the defendant believed such representations to be true.
(3) Whoever, with the intent—
(A) to promote the carrying on of specified unlawful activity;
(B) to conceal or disguise the nature, location, source, ownership, or control of property believed to be the proceeds of specified unlawful activity; or
(C) to avoid a transaction reporting requirement under State or Federal law,

conducts or attempts to conduct a financial transaction involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity, shall be fined under this title or imprisoned for not more than 20 years, or both. For purposes of this paragraph and paragraph (2), the term "represented" means any representation made by a law enforcement officer or by another person at the direction of, or with the approval of, a Federal official authorized to investigate or prosecute violations of this section.

(b) **Penalties.—**

(1) **In general.—** Whoever conducts or attempts to conduct a transaction described in subsection (a)(1) or (a)(3), or section 1957, or a transportation, transmission, or transfer described in subsection (a)(2), is liable to the United States for a civil penalty of not more than the greater of—

(A) the value of the property, funds, or monetary instruments involved in the transaction; or

(B) $10,000.

(2) **Jurisdiction over foreign persons.—** For purposes of adjudicating an action filed or enforcing a penalty ordered under this section, the district courts shall have jurisdiction over any foreign person, including any financial institution authorized under the laws of a foreign country, against whom the action is brought, if service of process upon the foreign person is made under the Federal Rules of Civil Procedure or the laws of the country in which the foreign person is found, and—

(A) the foreign person commits an offense under subsection (a) involving a financial transaction that occurs in whole or in part in the United States;

(B) the foreign person converts, to his or her own use, property in which the United States has an ownership interest by virtue of the entry of an order of forfeiture by a court of the United States; or

(C) the foreign person is a financial institution that maintains a bank account at a financial institution in the United States.

(3) **Court authority over assets.—** A court may issue a pretrial restraining order or take any other action necessary to ensure that any bank account or other property held by the defendant in the United States is available to satisfy a judgment under this section.

(4) **Federal receiver.—**

(A) **In general.—** A court may appoint a Federal Receiver, in accordance with subparagraph (B) of this paragraph, to collect, marshal, and take custody, control, and possession of all assets of the defendant, wherever located, to satisfy a civil judgment under this subsection, a forfeiture judgment under section 981 or 982, or a criminal sentence under section 1957 or subsection (a) of this section, including an order of restitution to any victim of a specified unlawful activity.

(B) **Appointment and authority.—** A Federal Receiver described in subparagraph (A)—

(i) may be appointed upon application of a Federal prosecutor or a Federal or State regulator, by the court having jurisdiction over the defendant in the case;

(ii) shall be an officer of the court, and the powers of the Federal Receiver shall include the powers set out in section 754 of title 28, United States Code; and

(iii) shall have standing equivalent to that of a Federal prosecutor for the purpose of submitting requests to obtain information regarding the assets of the defendant—

(I) from the Financial Crimes Enforcement Network of the Department of the Treasury; or

(II) from a foreign country pursuant to a mutual legal assistance treaty, multilateral agreement, or other arrangement for international law enforcement assistance, provided that such requests are in accordance with the policies and procedures of the Attorney General.

(c) As used in this section—

(1) the term "knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity" means that the person knew the property involved in the transaction represented proceeds from some form, though not necessarily which form, of activity that constitutes a felony under State, Federal, or foreign law, regardless of whether or not such activity is specified in paragraph (7);

(2) the term "conducts" includes initiating, concluding, or participating in initiating, or concluding a transaction;

(3) the term "transaction" includes a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, use of a safe deposit box, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

(4) the term "financial transaction" means

(A) a transaction which in any way or degree affects interstate or foreign commerce

(i) involving the movement of funds by wire or other means or

(ii) involving one or more monetary instruments, or

(iii) involving the transfer of title to any real property, vehicle, vessel, or aircraft, or

(B) a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree;

(5) the term "monetary instruments" means

(i) coin or currency of the United States or of any other country, travelers' checks, personal checks, bank checks, and money orders, or

(ii) investment securities or negotiable instruments, in bearer form or otherwise in such form that title thereto passes upon delivery;

(6) the term "financial institution" includes—

(A) any financial institution, as defined in section 5312 (a)(2) of title 31, United States Code, or the regulations promulgated thereunder; and

(B) any foreign bank, as defined in section 1 of the International Banking Act of 1978 (12 U.S.C. 3101);

(7) the term "specified unlawful activity" means—

(A) any act or activity constituting an offense listed in section 1961 (1) of this title except an act which is indictable under subchapter II of chapter 53 of title 31;

(B) with respect to a financial transaction occurring in whole or in part in the United States, an offense against a foreign nation involving—

(i) the manufacture, importation, sale, or distribution of a controlled substance (as such term is defined for the purposes of the Controlled Substances Act);

(ii) murder, kidnapping, robbery, extortion, destruction of property by means of explosive or fire, or a crime of violence (as defined in section 16);

(iii) fraud, or any scheme or attempt to defraud, by or against a foreign bank (as defined in paragraph 7 of section 1(b) of the International Banking Act of 1978)); [1]

(iv) bribery of a public official, or the misappropriation, theft, or embezzlement of public funds by or for the benefit of a public official;

(v) smuggling or export control violations involving—

(I) an item controlled on the United States Munitions List established under section 38 of the Arms Export Control Act (22 U.S.C. 2778); or

(II) an item controlled under regulations under the Export Administration Regulations (15 C.F.R. Parts 730–774);

(vi) an offense with respect to which the United States would be obligated by a multilateral treaty, either to extradite the alleged offender or to submit the case for prosecution, if the offender were found within the territory of the United States; or

(vii) trafficking in persons, selling or buying of children, sexual exploitation of children, or transporting, recruiting or harboring a person, including a child, for commercial sex acts;

(C) any act or acts constituting a continuing criminal enterprise, as that term is defined in section 408 of the Controlled Substances Act (21 U.S.C. 848);

(D) an offense under section 32 (relating to the destruction of aircraft), section 37 (relating to violence at international airports), section 115 (relating to influencing, impeding, or retaliating against a Federal official by threatening or injuring a family member), section 152 (relating to concealment of assets; false oaths and claims; bribery), section 175c (relating to the variola virus), section 215 (relating to commissions or gifts for procuring loans), section 351 (relating to congressional or Cabinet officer assassination), any of sections 500 through 503 (relating to certain counterfeiting offenses), section 513 (relating to securities of States and private entities), section 541 (relating to goods falsely classified), section 542 (relating to entry of goods by means of false statements), section 545 (relating to smuggling goods into the United States), section 549 (relating to removing goods from Customs custody), section 554 (relating to smuggling goods from the United States), section 641 (relating to public money, property, or records), section 656 (relating to theft, embezzlement, or misapplication by bank officer or employee), section 657 (relating to lending, credit, and insurance institutions), section 658 (relating to property mortgaged or pledged to farm credit agencies), section 666 (relating to theft or bribery concerning programs receiving Federal funds), section 793, 794, or 798 (relating to espionage), section 831 (relating to prohibited transactions involving nuclear materials), section 844 (f) or (i) (relating to destruction by explosives or fire of Government property or property affecting interstate or foreign commerce), section 875 (relating to interstate communications), section 922 (l) (relating to the unlawful importation of firearms), section 924 (n) (relating to firearms trafficking), section 956 (relating to conspiracy to kill, kidnap, maim, or injure certain property in a foreign country), section 1005 (relating to fraudulent bank entries), 1006 [2] (relating to fraudulent Federal credit institution entries), 1007 [2] (relating to Federal Deposit Insurance transactions), 1014 [2] (relating to fraudulent loan or credit applications), section 1030 (relating to computer fraud and abuse), 1032 [2] (relating to concealment of assets from conservator, receiver, or liquidating agent of financial institution), section 1111 (relating to murder), section 1114 (relating to murder of United States law enforcement officials), section 1116 (relating to murder of foreign officials, official guests, or internationally protected persons), section 1201 (relating to kidnaping), section 1203 (relating to hostage taking), section 1361 (relating to willful injury of Government property), section 1363 (relating to destruction of property within the special maritime and territorial jurisdiction), section 1708 (theft from the mail), section 1751 (relating to Presidential assassination), section 2113 or 2114 (relating to bank and postal robbery and theft), section 2252A (relating to child pornography) where the child pornography contains a visual depiction of an actual minor engaging in sexually explicit conduct, section 2260 (production of certain child pornography for importation into the United States), section 2280 (relating to violence against maritime navigation), section 2281 (relating to violence against maritime fixed platforms), section 2319 (relating to copyright infringement), section 2320 (relating to trafficking in counterfeit goods and services), section 2332 (relating to terrorist acts abroad against United States nationals), section 2332a (relating to use of weapons of mass destruction), section 2332b (relating to international terrorist acts transcending national boundaries), section 2332g (relating to missile systems designed to destroy aircraft), section 2332h (relating to radiological dispersal devices), section 2339A or 2339B (relating to providing material support to terrorists), section 2339C (relating to financing of terrorism), or section 2339D (relating to receiving military-type training from a foreign terrorist organization) of this title, section 46502 of title 49, United States Code, a felony violation of the Chemical Diversion and Trafficking Act of 1988 (relating to precursor and essential chemicals), section 590 of the Tariff Act of 1930 (19 U.S.C. 1590) (relating to aviation smuggling), section 422 of the Controlled Substances Act (relating to transportation of drug paraphernalia), section 38 (c) (relating to criminal violations) of the Arms Export Control Act, section 11 (relating to violations) of the Export Administration Act of 1979, section 206 (relating to penalties) of the International Emergency Economic Powers Act, section 16 (relating to offenses and punishment) of the Trading with the Enemy Act, any felony violation of section 15 of the Food and Nutrition Act of 2008 (relating to supplemental nutrition assistance program benefits fraud) involving a quantity of benefits having a value of not less than $5,000, any violation of section 543(a)(1) of the Housing Act of 1949 (relating to equity skimming), any felony violation of the Foreign Agents Registration Act of 1938, any felony violation of the Foreign Corrupt Practices Act, or section 92 of the Atomic Energy Act of 1954 (42 U.S.C. 2122) (relating to prohibitions governing atomic weapons) [3] environmental crimes

(E) a felony violation of the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), the Ocean Dumping Act (33 U.S.C. 1401 et seq.), the Act to Prevent Pollution from Ships (33 U.S.C. 1901 et seq.), the Safe Drinking Water Act (42 U.S.C. 300f et seq.), or the Resources Conservation and Recovery Act (42 U.S.C. 6901 et seq.); or

(F) any act or activity constituting an offense involving a Federal health care offense;

(8) the term "State" includes a State of the United States, the District of Columbia, and any commonwealth, territory, or possession of the United States; and

(9) the term "proceeds" means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity.

(d) Nothing in this section shall supersede any provision of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this section.

(e) Violations of this section may be investigated by such components of the Department of Justice as the Attorney General may direct, and by such components of the Department of the Treasury as the Secretary of the Treasury may direct, as appropriate, and, with respect to offenses over which the Department of Homeland Security has jurisdiction, by such components of the Department of Homeland Security as the Secretary of Homeland Security may direct, and, with respect to offenses over which the United States Postal Service has jurisdiction, by the Postal Service. Such authority of the Secretary of the Treasury, the Secretary of Homeland Security, and the Postal Service shall be exercised in accordance with an agreement which shall be entered into by the Secretary of the Treasury, the Secretary of Homeland Security, the Postal Service, and the Attorney General. Violations of this section involving offenses described in paragraph (c)(7)(E) may be investigated by such components of the Department of

Justice as the Attorney General may direct, and the National Enforcement Investigations Center of the Environmental Protection Agency.
(f) There is extraterritorial jurisdiction over the conduct prohibited by this section if—
(1) the conduct is by a United States citizen or, in the case of a non-United States citizen, the conduct occurs in part in the United States; and
(2) the transaction or series of related transactions involves funds or monetary instruments of a value exceeding $10,000.
(g) **Notice of Conviction of Financial Institutions.—** If any financial institution or any officer, director, or employee of any financial institution has been found guilty of an offense under this section, section 1957 or 1960 of this title, or section 5322 or 5324 of title 31, the Attorney General shall provide written notice of such fact to the appropriate regulatory agency for the financial institution.
(h) Any person who conspires to commit any offense defined in this section or section 1957 shall be subject to the same penalties as those prescribed for the offense the commission of which was the object of the conspiracy.
(i) **Venue.—**
(1) Except as provided in paragraph (2), a prosecution for an offense under this section or section 1957 may be brought in—
(A) any district in which the financial or monetary transaction is conducted; or
(B) any district where a prosecution for the underlying specified unlawful activity could be brought, if the defendant participated in the transfer of the proceeds of the specified unlawful activity from that district to the district where the financial or monetary transaction is conducted.
(2) A prosecution for an attempt or conspiracy offense under this section or section 1957 may be brought in the district where venue would lie for the completed offense under paragraph (1), or in any other district where an act in furtherance of the attempt or conspiracy took place.
(3) For purposes of this section, a transfer of funds from 1 place to another, by wire or any other means, shall constitute a single, continuing transaction. Any person who conducts (as that term is defined in subsection (c)(2)) any portion of the transaction may be charged in any district in which the transaction takes place.

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[1] So in original. The second closing parenthesis probably should not appear.

[2] So in original. Probably should be preceded by "section".

[3] So in original. Probably should be followed by a semicolon.[393]

§ 1957. Engaging in monetary transactions in property derived from specified unlawful activity

(a) Whoever, in any of the circumstances set forth in subsection (d), knowingly engages or attempts to engage in a monetary transaction in criminally derived property of a value greater than $10,000 and is derived from specified unlawful activity, shall be punished as provided in subsection (b).
(b)

[393] See Legal Information Institute, http://www.law.cornell.edu/uscode/718/ usc_sec_18_00001956----000-.html.

(1) Except as provided in paragraph (2), the punishment for an offense under this section is a fine under title 18, United States Code, or imprisonment for not more than ten years or both.
(2) The court may impose an alternate fine to that imposable under paragraph (1) of not more than twice the amount of the criminally derived property involved in the transaction.
(c) In a prosecution for an offense under this section, the Government is not required to prove the defendant knew that the offense from which the criminally derived property was derived was specified unlawful activity.
(d) The circumstances referred to in subsection (a) are—
(1) that the offense under this section takes place in the United States or in the special maritime and territorial jurisdiction of the United States; or
(2) that the offense under this section takes place outside the United States and such special jurisdiction, but the defendant is a United States person (as defined in section 3077 of this title, but excluding the class described in paragraph (2)(D) of such section).
(e) Violations of this section may be investigated by such components of the Department of Justice as the Attorney General may direct, and by such components of the Department of the Treasury as the Secretary of the Treasury may direct, as appropriate, and, with respect to offenses over which the Department of Homeland Security has jurisdiction, by such components of the Department of Homeland Security as the Secretary of Homeland Security may direct, and, with respect to offenses over which the United States Postal Service has jurisdiction, by the Postal Service. Such authority of the Secretary of the Treasury, the Secretary of Homeland Security, and the Postal Service shall be exercised in accordance with an agreement which shall be entered into by the Secretary of the Treasury, the Secretary of Homeland Security, the Postal Service, and the Attorney General.
(f) As used in this section—
(1) the term "monetary transaction" means the deposit, withdrawal, transfer, or exchange, in or affecting interstate or foreign commerce, of funds or a monetary instrument (as defined in section 1956 (c)(5) of this title) by, through, or to a financial institution (as defined in section 1956 of this title), including any transaction that would be a financial transaction under section 1956 (c)(4)(B) of this title, but such term does not include any transaction necessary to preserve a person's right to representation as guaranteed by the sixth amendment to the Constitution;
(2) the term "criminally derived property" means any property constituting, or derived from, proceeds obtained from a criminal offense; and
(3) the term "specified unlawful activity" has the meaning given that term in section 1956 of this title.

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